

STATE, SOCIETY AND DEVELOPMENT IN THE PACIFIC

ANALYSING STRUCTURAL ADJUSTMENT IN THE
COOK ISLANDS AND PAPUA NEW GUINEA

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CHAPTER ONE

INTRODUCTION

State and Society in Economic Development

The final decades of the twentieth century were marked by a massive restructuring and transformation of global political and economic activities. The collapse of the Bretton Woods agreement in the early 1970s, and the subsequent wide-ranging effects of this collapse showed how increasingly interdependent the global political economy really was. Countries around the globe from the first world to the third underwent dramatic periods of domestic restructuring in order to keep abreast of these momentous changes. It is this global flux of restructuring which provides the initial context for this thesis. At the heart of this global transformation is a radical shift in economic policies and organisational structures away from the interventionist prescriptions of Keynesianism, and towards a renewed emphasis on the neo-classical model of market liberalisation as the means of achieving economic growth and development.¹ This new, broad current of economic policy prescription – often termed neo-liberalism – has generally been consistent in its implementation throughout the world. In the last two decades many developing countries around the world have thus adopted economic reform programs aimed at reducing balance of trade deficits, lowering the domestic rate of inflation and increasing levels of private investment – all in the hope of increasing domestic levels of economic development through the mechanisms of the free market. Known more commonly by the broad term structural adjustment², these reform programs refer to policy packages that include among their essential features macro-economic stabilisation (with an emphasis on fiscal and monetary policy), the liberalisation of goods and factor markets through deregulation and the simultaneous reduction of external barriers and

¹ By renewed emphasis I am referring to the *laissez-faire* policies predominate in the global political economy throughout the nineteenth century up until the end of World War One.

² The genesis for these programs of economic reform can be found in the resurgence of the neo-classical economic paradigm of competitive markets in the wake of the global crises of the 1970s. This neo-classical ideology behind the majority of political, social and economic reform efforts in the last two decades has been devoted largely to the creation of competitive markets. However, while efforts to improve the functioning of markets in developing countries may have had a positive impact on growth in recent years, the impact of these reforms on equity may be less than optimal.

controls, and the privatisation (to varying extents) of the public enterprise sector.³ The severe initial social costs characteristic of these reform programs mean, however, that their goals of increased economic development and macro-economic growth are often only achieved with varying degrees of success.⁴ (UNDP 1997) This inability to achieve the full benefits of these reform programs has led a number of theorists to reason that the failure of these programs is due to the fact that many of the states of the developing world possess a low level of capability to implement and maintain the impetus of these reforms in the face of high levels of social unrest.

This thesis thus takes as its initial starting point the proposition that reform success in the developing world is a function of state capacity. This, however, is a far more complicated question than initial scrutiny might lead one to believe, as recent work has suggested that state capacity is, paradoxically, a function of the degree of connectivity between the state and wider society. This emerging body of literature has persuasively demonstrated that a high level of connectivity between the institutions of the state and wider civil society, variously known as embeddedness, can, contrary to earlier doctrine, actually lead to the strengthening of the institutions of the state through the effective expansion of the capacity of the state. (see Evans 1997; Migdal, Kohli and Shue 1994) Periods of structural adjustment were chosen as the empirical context for this thesis, as the logic of an economic stabilisation program, and the more long term structural adjustment program, is not merely to cut trade and budget deficits by reducing consumption, but also to shift the whole structure of domestic production of an economy

³ Structural adjustment programs began initially as a way for countries to obtain foreign exchange in order to pay back international debtors. Before 1985 structural adjustment had been given a narrow interpretation, concerned more with adjustment to outside shocks such as the oil price increases of the 1970s, and the debt crises of the 1980s. By the mid-1980s however, the social problems associated with the implementation of the standard adjustment measures had led to widespread criticism of the Bretton Woods institutions that were the primary promoters of adjustment in the developing countries. As a result of this criticism the IMF and the World Bank began to modify their working definitions of the goals of successful adjustment towards the notion of adjustment 'with a human face' through the incorporation of social issues such as human rights and concern for the poor into their programs, and by becoming more flexible on the forms of conditionalities associated with their adjustment lending. Throughout this period Structural Adjustment increasingly came to embrace all the objectives of what had earlier been covered by the term 'development'.

⁴ There are a number of mechanisms through which structural adjustment programs can lead to increases in poverty and in levels of inequality. The devaluation of currencies may lead to retail price increases for imported goods. Prices of goods and services in general may rise as Government subsidies are removed. Government cut backs may mean both that Government services to the poor are cut, and unemployment rises as public sector jobs are eliminated.

so as to increase the country's ability to earn foreign exchange while simultaneously reducing domestic demand for foreign exchange.

Structural change is [thus] change *of* a system rather than change *within* a system. It involves the modification of the rules of the game that frame organisational interaction, define organisation roles, responsibilities and relationships and regulate inter-organisational competition and conflict. (Metcalf 1993: 182)

Periods of structural adjustment and economic stabilisation thus provide an ideal opportunity to explore the critical role that linkages in developing countries between state and society play in the realisation of political and economic goals.

Structural Adjustment Programs

There are a number of reasons why governments decide to implement stabilisation and structural reform measures.⁵ These reasons can include a combination of factors such as: serious domestic economic crisis; reduction in the power of the groups with the strongest vested interests in the status quo; decisive political leadership working within a competent and cohesive technocracy; and changes in the international environment. (Haggard and Kaufman 1992a, 1995; Nelson 1990, 1994; Williamson 1994) In the smaller and poorer countries of the developing world these programs of reform are often instigated as a pre-condition of funding aid from multi-lateral institutions such as the World Bank or the Asian Development Bank or direct bi-lateral aid from more prosperous countries. This is not to say, however, that all programs of reform undertaken by the small and poor countries of the world are forced upon them by external agencies. The period of structural reform undertaken by Papua New Guinea in the mid-1990s was composed not only of an external aid-conditionality component, but may also be traced in part back to a domestic desire to restructure the institutions of the country in order to bring domestic arrangements more in line with the APEC-derived free trade aims of the Osaka Agenda.

⁵ Much of the recent development literature has promoted the neo-classical conception that the market is the governance mechanism best suited to the achievement of economic development due to its 'naturally' allocative capacity. This theoretical belief has been transferred into empirical policy reality in developing countries around the world through the instigation of short-term programs of economic stabilisation and associated longer-term programs of structural reform.

Economic Stabilisation and Structural Adjustment

The mechanics of economic stabilisation programs and related periods of structural adjustment are by necessity complicated. Nonetheless, each process can be seen to contain a number of key basic components. Economic stabilisation programs are primarily designed to control the rate of inflation in order to provide domestic macroeconomic stability through the correction of imbalances in government budgets, balance of trade deficits and the money supply. To that end the implementation of these programs necessitates that the governments of the economies being stabilised impose a series of difficult austerity measures, such as cuts in government expenditure and/or increases in taxation, wage freezes in the public and the private sector, devaluation, credit restrictions (particularly on public-sector borrowing from the banking system), and increased real interest rates. Structural adjustment, by contrast, is a longer term process whereby the reduced fiscal disequilibria from a program of economic stabilisation is set in place through the construction of appropriate institutional structures – with the long term goal being the establishment of sustainable macroeconomic conditions. These structural adjustment reform programs generally contain five interrelated components: they free up restraints to the operation of the free market; controlled prices are adjusted to scarcity values; resources are shifted through the process of privatisation from state control to private ownership; the government's remaining role in guiding development is rationalised; and governmental institutions are reformed in order to carry out government's new roles. (Roemer and Radelet 1993: 67; cf Haggard and Kaufman 1992a) Structural adjustment programs thus aim to reduce budget deficits and tighten monetary policy through the liberalisation of trade and exchange rate regimes – processes which are in general part of the longer term plan to expand the role of market forces and the private sector. Generally speaking, economic stabilisation, as a strategy of reform, is frequently a precondition to a period structural adjustment.⁶ (Roemer and Radelet 1993: 65)

While structural adjustment programs are designed to provide the correct institutional context for economic development, this process is complicated by the fact that in most

⁶ However this is not always the case, as the example of the Cook Islands suggests. The long term plans of reform in the Cook Islands were overwhelmed by the fiscal crisis of early 1996, which led to the early initiation of big cuts in the country's civil service.

cases the economic reforms characteristic of these adjustment packages mean that severe social costs are imposed early on in the process with few, if any, immediate accompanying benefits. The success of structural adjustment programs can therefore be seen to be dependent upon the ability of the state to not only implement but also to maintain the impetus of the reform objectives. Problems can thus ensue when the state has a low ability to implement and maintain these reforms. (Corkery 1997) These problems of low state capacity can, however, be overcome if governments are able to acquire the support of various sections of wider society. (Haggard and Kaufman 1992: 20, 1992a: 8) The existence of diverse and multitudinous networks of support for the state within society can thus play a crucial part in the success of programs of reform due to the ability of these ties to effectively enhance the capacity of the state. The success or failure of the structural reform process in the developing regions of the world can therefore be seen to be heavily dependent upon the nature of the linkages between domestic political and social institutions. (Perkins and Roemer 1993: 7-8) This realisation of the negative relationship between low state capacity and low levels of reform success shook the neo-liberal foundations of the development fraternity. The recognition that state capacity directly affected the success of programs of economic reform was contrary to the widely held neo-classical belief that the market was the most efficient form of governance mechanism and led to a questioning of the necessarily anti-state foundations of then current development thinking.

Crisis of Governance

By the early-1990s staff at multi-lateral lending institutions such as the World Bank, and academics and policy analysts around the world had begun to notice a disturbing trend in structural adjustment programs. They were not working. (World Bank 1992) Standard structural adjustment programs had relied heavily upon neo-classical economic foundations for their design and implementation. These ideas had been found wanting in developing countries where the lack of any strong institutional framework meant that the 'invisible hand' of the market had been unable to function effectively. The identification of this 'crisis of governance' led to modification to the thinking behind the process of structural adjustment and the re-focusing of development discourse upon the problem of 'Good Governance.'

The 'Good Governance' discourse is fundamentally concerned with the way in which power is exercised in the management of a country's social and economic resources for development. (ADB 1995; World Bank 1992, 1994) The 'Good Governance' agenda is based upon the belief that the failure of structural adjustment programs to bring about the economic development that they had so promisingly offered was due to the inability of 'correct' economic policies to be implemented in the absence of the 'correct' governance structures and institutions. (Larmour 1998: 5) Before policies of economic growth can be implemented the 'Good Governance' discourse therefore asserts that a 'correct' institutional framework is required in order to facilitate the functioning of the free market. There are six attributes essential to the creation of this 'correct' institutional framework, these being: participation; transparency; accountability; rule of law; effectiveness; and equity. A major objective of the 'Good Governance' influenced structural reform process is thus to promote constructive interaction amongst all sectors of state, market and society in order to achieve these six goals.

The Good Governance agenda is therefore intricately concerned with notions of civil society, as the empowerment of civil society can lead to the promotion of notions of accountability, legitimacy, participation and transparency; all key areas in the Governance framework. While civil society is often defined negatively as that which is not of the state – a distinction which can be traced back to Thomas Hobbes (1983) and John Locke (1978, 1997)⁷ – it can, however, be defined positively in the sense that it is the framework of institutions such as familial kinship structures, and informal and formal voluntary associations which exist independently of any centralised political authority.⁸ It is this positive sense, in turn, which has been so central to the emergence of the governance agenda, as in the World Bank's view, the institutions and organisations of civil society play an important role as they can create vertical links between the state and citizen, thereby voicing local concerns more effectively and exerting greater pressure on

⁷ These two theorists argued that since there it was hypothetically possible to dispense with a centralised political authority such as the state, there was a need for a concept to describe the relationships within which the remaining institutions were embedded – a distinction which can still be seen to continue to be present in much current work, with Ernest Gellner for instance negatively defining civil society as "the social residue left when the state is subtracted" (1994: 212) Civil society, as a conceptual variable, thus has a long history been defined in much modern literature as an unwilled 'natural' entity distinct and separate from the willed political order of the state. (Lively and Reeve 1997)

⁸ There is also often a normative component in definitions of civil society, most clear in de Tocqueville's work *Democracy in America* (1969), which argues that a functioning civil society is critical, and crucial component of any vibrant political and economic order.

public officials for higher levels of performance and accountability. (World Bank 1993: 61; see also World Bank 1992: 49) Governance issues thus concern not only the correct functioning of official political institutions such as the state, but also the complex mechanisms, processes and institutions through which citizens and groups exercise political, economic and administrative authority in the management of a country's affairs at all levels.

Governance includes the state, but transcends it by taking in the private sector and civil society. All three are critical for sustaining human development. The state creates a conducive political and legal environment. The private sector generates jobs and income. And civil society facilitates political and social interaction – mobilising groups to participate in economic, social, and political activities. Because each has weaknesses and strengths, a major objective of our support for good governance is to promote constructive interaction among all three. (UNDP 1997: 2)

The emergence of the 'Good Governance' agenda has thus lead to the realisation, even amongst some of the most neo-liberal institutions in the world (World Bank 1993, 1997), of the continued need for the state to provide an enabling environment for the coordination and construction of the appropriate institutional framework for the functioning of the market.⁹ The problem is therefore not so much whether the state should be involved as it is a question of how the state should be involved, for "although market reforms suggest a lesser role for the state, any well-functioning economic system still requires a well-functioning government." (Perkins and Roemer 1993: 6; see also Kochanowicz 1994: 196-199) The problems associated with constructing this enabling environment have also led to the necessary widening of the scope of adjustment lending to incorporate the widest possible sense of the political and the economic, with questions concerning the possible positive effect of linkages between the state and wider society impacting on the international developmental community through the recent publication of a number of influential reports. (World Bank 1993, 1997) This expansion of the scope of development thinking has also been mirrored by a similar transformation in the

⁹ The new institutional economics with its focus on the need for institutional frameworks to provide governance structures for economic transactions further supports this argument. See Douglass C. North

theoretical literature on development away from ‘state-versus-society’ forms of theorising into a more holistic ‘state-in-society’ approach. This new approach has led to a radical restructuring of the way in which the concept of state capacity is theorised.

State or Society

Various defined as instruments of domination (Miliband 1983; Poulantzas 1980), corporate actors (Evan, Rueschemeyer and Skocpol 1985), arenas of social conflict (Lowi 1969/1979; Nordlinger 1981) and the guardian of the universal interest of society over which it has jurisdiction (Hobbes 1651/1987) the role of the state in development discourse and social theory has a long and varied history. From the Greek city-state to the East Asian developmental state it has figured as one of the primary units in analyses of the political. Throughout this long and varied history however, one key question continually provokes both discussion and argument amongst theorists: what is the nature of the relationship between the state and wider society? This question has been couched in many different guises and forms, but regardless of whether or not it is posed as a question of state strength (Dauvergne 1998; Migdal 1987, 1988), state power (Mann 1984) or state effectiveness (World Bank 1991, 1993, 1997) the core concern underlying all these approaches is the same – that of the relationship between state and society – and it is this core concern that is the driving force behind the construction of this thesis.

The state is generally defined as the authoritative and legitimate institution identified with a specific geographic territory through which the body of citizens associated with that territory are ordered, organised and controlled. The state is differentiated from other institutions within society in that its authority is legal in nature and is therefore based on procedural rules which have more general recognition in society than other rules. The state also possesses both the maximal control of resources within the territory and the only legitimate monopoly on the use of coercive force in the territory. (Weber 1964) As an organisation, the state is composed of numerous agencies that are coordinated and led by a centralised executive authority (the government), that has the ability and authority to make and implement binding rules by which individuals, and other organisations within

(1990) *Institutions, Institutional Change and Economic Performance* (Cambridge: Cambridge University Press) and Oliver Williamson, (1985) *The Economic Institutions of Capitalism* (New York: Free Press).

the specified territory of the state, must abide.¹⁰ A glaring deficiency in this general Weberian definition of the state is, however, the lack of any attention to the question of community. (Larmour 1992: 101) The realisation of this lack of attention to the notion of community has resulted, in the last thirty years, in a dramatic transformation in theorising on the role and powers of the state.

Up until the beginning of the 1980s the majority of social and political analyses tended to reduce the role of the state to little more than a tool of particular social groups (Lowi 1969/1979; Nordlinger 1981) or economic classes (Block 1978; Miliband 1983; Poulantzas 1978, 1980). These Pluralist and Marxist perspectives, however, came under attack in the early 1980s from an emergent group of European and American theorists – later known as the Statists – who claimed that these analyses had placed too much emphasis on the society side of the state-society nexus – a process which had in turn reduced the role of the state to little more than a dependent variable in any analysis. With the 1985 release of their book *'Bringing the State Back In'*, Peter Evans, Dietrich Rueschemeyer and Theda Skocpol thus brought the state out of the conceptual wilderness and back into the academic fold as a legitimate and important variable in social analysis. These Statists argued, in contrast to the earlier Marxist and Pluralist viewpoints, that the power of institutions such as the state to constrain action must be taken seriously in any analysis of the political. Strongly Weberian in their approach, the Statists argued that state officials should not be seen merely as members of society who happened to work for the state, but instead should be viewed as careerists who identify closely with their vocation. Rather than acting on their own preferences these careerists acted on those of the state – thus state policies were unable to be reduced to the impact of mere societal preferences. Statists thus emphasised the degree of centralisation of the modern state, and the extension of state power over society. However, although the impact of the Statists was dramatic, and led to a renewed interest in the functioning of the institutions of the state in both the developed and developing world, their overly deterministic analyses were open to a number of criticisms. By placing an inordinate amount of theoretical weight upon state structures and political legacies in defining state action Statists effectively excluded any real consideration of both society and individual action

¹⁰ Larmour (1992: 102) distinguished between the state “as a permanent bureaucratic apparatus” and government “as a smaller and usually transient group of politicians and senior officials who try, with more or less success, to give state activity coherence and direction.”

in their analyses. Thus, by the end of the 1980s, theorists dissatisfied with the overly deterministic conceptions of the state offered by the Statists – an exclusion which left them open to the same charge of over-determinism that they had earlier laid against Marxist and Pluralist forms of analysis – began to argue that it was time to “bring society back in.” (Clark and Chan 1994: 333)

State and Society

The French philosopher Michel Foucault has argued that:

relations of power, and hence the analysis that must be made of them, necessarily extend beyond the limits of the state...First of all because the state, for all the omnipotence of its apparatuses, is far from being able to occupy the whole field of power relations, and further because the state can only operate on the basis of other existing power relations. (Foucault 1984: 312)

This concern with integrating the state within the broader context of society underlies much of the recent literature on the role of the state in economic and political change. Wary of falling into the trap of social determinism characteristic of earlier Marxist and Pluralist approaches, the theorists of this new body of literature are also keenly aware of the danger of descending into the state-centred determinism of the Statists. Realising that the state is necessarily embedded within a complex historically contingent matrix of social forces, which both constrain and empower action, recent theorists of the state have brought the notion of society back into focus as an important variable in the analysis of state capacity. (Clark and Chan 1994; Evans 1989; 1992, 1995, 1996, 1997, 1997a; Migdal, Kohli and Shue 1994) Moving beyond the zero-sum ‘state or society’ formulations of earlier perspectives these new theoretical frameworks embrace a synergistic ‘state-in-society’ approach in which state-society relations can be seen to lead to positive effects of mutual empowerment. This new perspective has much in common with the emergent ‘Good Governance’ agenda, wherein government performance can be perceived as much a function of civic ties as it is a function of institutional design. (Larmour 1998: 10) Focusing on the associational spaces that exist between the authority of the state and the exchange relations of the market this approach is based upon the assumption that informal networks, formal associations and other civic groups that fill

these spaces provide critical mechanisms of coordination and resource allocation within societies. (cf Hollingsworth, Schmitter and Streeck 1994; Lipton 1991) Thus;

states and markets are both essential mechanisms of social coordination, but they work best when they are rooted in networks and associations that cushion risks and build trust among the relevant economic actors. (Kaufman 1999: 368)

The use of this state-in-society approach thus allows us to take into consideration the roles that individuals not situated in either the market or electoral politics may play in this process, thereby widening the scope of the political, as an understanding of the politics of reform requires not only the identification of the relevant actors in the political process and the specification of their preferences and political resources but also the analysis of the constraints placed upon action by existing social and political structures. The use of this approach can also help overcome the critique that is often made of comparative analyses, that they are overly structural in their approach (Kiser and Hechter 1991), without having to resort to a mere interpretive description of events. Taking much from institutional sociology with its emphasis upon the broader socio-cultural context in which bureaucratic and economic behaviour is embedded, this state-in-society approach implies that the politics of reform will be characterised less by the calculated pursuit of income or power than by more reflexive normative behaviour which is in turn itself the result of a historically contextualised matrix of social relations and institutions thereby emphasising the path-dependant nature of social and political transformations within individual national societies and sub-national regions. (Stark 1992)

What this thesis proposes to do then, is to explore the relationship between state-society connectedness and the associated levels of success in implementing and maintaining structural adjustment programs. In doing so this thesis is based upon the investigation of three interrelated propositions. These being:

- 1) Is the state-in-society approach a valid model to use in the construction of developmental policy;
- 2) Does this form of interaction lead to the successful achievement of developmental objectives; and therefore;
- 3) Is the state-in-society approach thus a valid developmental model?

In order to explore these propositions, two recent cases of structural adjustment, one in Papua New Guinea and one in the Cook Islands, have been chosen as the empirical vehicle for this investigation. These two countries provide an excellent opportunity for comparative analysis for a number of key reasons.¹¹

Introducing the Cases

With over five hundred separate languages and cultures spread over the various islands that constitute the territory of modern Papua New Guinea, it can rightly be called one of the most ethnically diverse countries in world. Environmental factors combined with a high level of social diversity and associated lack of national integration within its population of approximately four million have meant that the problems of economic development that face Papua New Guinea are extreme. In stark contrast to the diverse nature of Papua New Guinea society, the micro-state of the Cook Islands, situated in the south-western Pacific basin is one of the most ethnically homogenous countries in the world.¹² While the smallness of the Cook Islands population (now approximately 16 500) would lead one to believe that the problems of economic development faced by the country would be no where as extreme as those faced by a larger country such as Papua New Guinea, the problems of extreme physical remoteness brought about by having a total dry land surface area of just over 200 square kilometres spread over 13 islands covering over a million square kilometres of the Pacific Ocean means that the Cook Islands have encountered major difficulties in increasing indigenous levels of economic development. The onset of economic crises in both these countries in the mid-1990s meant that both countries were forced to undergo periods of structural adjustment and reform, and it is these periods of structural reform that provide the context for the comparative analysis of the question of the relationship between state-society interaction and the achievement of developmental objectives. Both countries have also only recently

¹¹ While the best method of testing these propositions may have involved the comparison of a single country undergoing two separate periods of reform, one in the 'Washington Consensus' era and one in the 'post-Washington Consensus' era, the recent nature of the paradigm shift means that reforms undertaken under the aegis of this new model would, at this point in time, only be in their first year of implementation at best.

¹² The indigenous languages spoken on the island groups that make-up the modern Cook Islands are all mutually intelligible, although some dialectal difference are apparent especially between those of the Northern Group, where some of the islands were exposed to a strong cultural influence from the societies of Western Polynesia.

achieved freedom from colonial rule – with Papua New Guinea achieving independence from Australia in 1975 and the Cook Islands achieving self-government from New Zealand in 1965.¹³ The fact of recent self-government means that the structures of the state in both countries are relatively new, and hence not as developed as those in countries with longer independent histories, which effectively means that both of these states are still necessarily dependent upon wider social support for both their legitimacy and wider operational existence. This necessary need for wider social support means that both states actively require a degree of social connectedness in order to achieve their developmental goals, thereby providing the necessary context for the comparative analysis undertaken by this thesis. Additionally, the high degree of similarity in the underlying objectives of the reforms in the two countries combined with the fact that their reforms were also undertaken at about the same time and over approximately the same time period mean that the two cases provide an ideal opportunity for comparison.

In order to investigate these questions the thesis is structured along the following lines. Chapter two presents a brief outline of the development of ‘development’ thinking over the last century. Tracing out the interconnections between changes in the international environment and changes in the spheres of comparative politics and developmental policy this chapter draws attention to the recent emergence of the new state-in-society paradigm in international developmental thinking. The chapter then demonstrates the linkages between the Developmental State literature, with its focus on embedded autonomy, and the emergence in recent years of a dramatic shift in developmental policy focus, a shift exemplified best by the emergence of the post-Washington Consensus. The thesis then explores two discrete case studies. In this second section of the thesis recent structural adjustment programs in the Cook Islands and Papua New Guinea are explored in order to investigate the extent to which state-society linkages have contributed to the success, or lack of success, of these programs of reform. The construction of these cases involved periods of fieldwork in both countries, where numerous interviews were carried out with both public and private sector representatives. Whilst conducting this fieldwork

¹³ While Papua New Guinea is fully independent from Australia, and has been since 1975, the Cook Islands operate in a state of free association with New Zealand. This state of free association means that while the Cook Islands are fully sovereign in their domestic government some foreign affairs duties such as defence are carried out by the New Zealand government, but even then only at the request of the Cook Islands government. Additionally all Cook Islanders are automatically New Zealand citizens. The implications for this association are explored more fully in the later chapter specifically on the experiences of the Cook Islands. The Cook Islands are free to leave this arrangement at any time.

extensive use was also made of local newspapers and other archival sources. The third and final section of this thesis then analyses these case studies in terms of the applicability of the state-in-society approach to the success or failure of their respective programs of reform. The final chapter concludes the thesis by offering up a possible motive for the success of the Cook Islands program and failure of the Papua New Guinea reform program. Arguing that the key difference between the two countries may be their degree of social homogeneity, it asserts that social homogeneity may have been a necessary variable in the success of the East Asian developmental states. The final chapter argues, however, that through a renewed recognition of the need to root all processes of development within the particular context faced of each community, region or country there may still be hope in salvaging the developmental state paradigm as a valid developmental model.

CHAPTER TWO

CHANGING PERSPECTIVES ON STATE AND SOCIETY IN DEVELOPMENT THEORY

Early Developments

The study of the interaction of the state with society in the promotion of economic and political development has had a long and turbulent history for much of the twentieth century. While the period preceding World War One was characterised by the continuance of the laissez-faire policies so pre-eminent in the nineteenth century, the momentous changes that World War One brought to the international environment, combined with the shock of the Great Depression, led Governments around the globe to become more directly and deeply involved in the economy. The expansion of the role of the state was initially somewhat spontaneous as governments responded to the decline in international demand for export products. These initial reactions were consolidated throughout the mid-twentieth century by the rise and spread of Keynesianism. With its stress on demand-side economics, Keynesian-derived economic policy necessitated the existence of a strong and pervasive state. However, this state strength was dependant, at least in part, on connections to wider society. Thus, apart from the Fascist states of the pre-World War Two era, and the Socialist governments of Eastern Europe and East Asia, states across the world maintained strong connections with non-state groups such as labour unions in order to increase their capacity to implement and maintain policy decisions. The state was thus an important social system in the developed countries of the world in the period immediately preceding and following World War Two, as a strong state was a necessary adjunct for the establishment of the industries and production-line methods of the Keynesian-Fordist forms of economic development characteristic of this period.¹

¹ Fordism was an ideology of production characterised by four major themes, these being (i) mass production for mass consumption; (ii) managerial guidance by a combination of government and corporate planning; (iii) a high degree of cooperation between governments in international trade policy; and (iv) a form of domestic politics revolving around organised working class and business interests. Emerging in the wake of the devastation of World War Two, Fordism's heyday as a mode of production peaked in the 1950s and 1960s.

The wide-ranging devastation of World War Two, and the desire to escape from a similar catastrophic upward spiral of inflation as had happened in the years following World War One, led the leading powers of the era to create the Bretton Woods system. With the goal of international economic stabilisation, the dual institutions of the Bretton Woods system – the International Monetary Fund and the World Bank – were created in order to oversee and coordinate the maintenance of favourable balances of trade. In order to achieve this goal the currencies of the world were pegged to the US dollar which was in turn fixed in terms of gold. While governments maintained their economic sovereignty at a national level, the Bretton Woods institutions coordinated these governments financial movements at the global level, issuing reports which allowed governments around the world to control their capital movements through the manipulation of exchange and interest rates. The growth and development of the 1950s that the success of the Bretton Woods system and the Marshall plan allowed Japan and the war-ravaged states of Europe to enjoy also led to an increasing awareness by the international community of the wide income differentials among the 'developed' and 'developing' countries of the world. This awareness led to the Bretton Woods institutions taking on a new role – that of channelling foreign aid to the 'developing' countries of the world. Following in the apparent success of Keynesianism, the preferred conduit for the distribution of this aid in these developing countries was the state. The 1950s thus saw the emergence of new 'development economic' theories in response to the under-development of large numbers of countries around the world. Arguing along a Keynesian framework that market failures were holding back the development of these states these theories argued that the state needed to play a central role in the development process. These market failures were identified by these development economists as being produced by the presence of externalities, monopolies, and a general lack of mobility of factors of production. These failures were not insurmountable, however, and were able, so these development prescriptions argued, to be overcome through state based industrial pushes. The 1950s were thus witness to the emergence of a new form of development paradigm – Modernisation theory.

Modernisation Theory

Based on the argument that external flows of capital, trade and technology had positive effects on national development, Modernisation theory argued that

developmental growth was dependant upon the creation of policies designed to attract foreign capital. (Deutsch 1961; Lipset 1959; Rostow 1963) In order to attract such foreign capital, Modernisation theory argued that structural changes needed to be made to the institutional and organisational make-up of developing countries. Traditional institutions and organisations were seen as pre-state and therefore pre-rational, with traditional institutions perceived as hindering the operation of capitalist markets. (Huntington 1968) In order to modernise and achieve economic development, Modernisation theorists therefore argued that developing societies needed to adopt the same organisational and institutional structures – as well as the associated political and social values – as those possessed by the developed states of the world. The adoption of these ‘modern’ institutional and organisational structures was in turn dependant upon the assumption that state apparatuses could be used to foster the structural changes necessary in order to bring about development. This process of institutional re-structuring was dependant upon three key interrelated goals, these being - (i) the rapid acceleration of industrialisation; (ii) the modernisation of agricultural forms of production; and (iii) the provision of the infrastructure needed in order to facilitate increased levels of urbanisation. These early development theorists thus perceived the dense matrix of social ties that bound individuals and institutions together within society as an impediment to development.

Dependency and Dependencia Theories

The only major critiques of Modernisation theory in the 1960s and early 1970s were that of the neo-Marxist Dependency and Dependencia schools. The first such theorist to voice his concerns at the theoretical failings of modernisation theories was Andre Gunder Frank (1967) who argued that the economic dynamics of capitalism created social and political institutions of exploitation - resulting in the movement of capital surplus from the developing 'peripheral' countries to the developed 'core' countries. Called 'Dependency' theory by its supporters, it argued that governments and culture were only epiphenomenal to the question of development. (Deyo 1981; Evans 1979; Hayter 1971; Payer 1974) The only hope for true development for these peripheral countries, so these theorists argued, was through the dismantling of the international structures of accumulation that they saw as responsible for the continued repression and state of dependency of the developing world. A related school of thought emerged in Latin America at about the same time as Frank's theory of Dependency.

Called Dependencia theory it argued that the lack of development in Latin America was not due just to the structure of the international political economy, but was also heavily dependent upon the complex interaction of domestic forces including political structures, social movements and historically conditioned alliances. (Cardoso and Faletto 1979) This more sophisticated theory was a distinct attack upon Modernisation theory which had long argued that political stability was of key importance in the development process, as political legitimacy and accountability were of secondary importance to the attainment of economic and technological development.² (Huntington 1968)

The modernisation/dependency paradigms dominated discourse on the comparative politics of development for almost two decades. However, the dramatic changes of the international environment in the 1970s and 1980s from a Fordist to post-Fordist international order foreshadowed a similar shift away from this Modernisation/Dependency nexus of development discourse, and towards the emergence of new forms of development paradigms.³

Dramatic Changes in the International Environment

The 1960s signalled the beginning of the crisis of the Keynesian-Fordist model of economic growth predominant in the post-World War Two international environment. By this point in time the post-War Western European and Japanese economic recoveries were complete. Their internal markets were saturated with domestic consumption products, and it was only a matter of time before the drive to create export markets for these same products meant that the US position of export hegemony would be threatened. This recovery of these states' economies occurred just as the success of the Fordist rationalisation model meant that increasing numbers of workers in these countries were being displaced. (Harvey 1989: 141) The accompanying decline in effective demand brought about by this process further contributed to the building crisis in the international economic system. These various

² Huntington (1968) argued that political instability resulted when demands exceeded a political systems capability.

³ While a strong correlation may be drawn from the similarity of these changes further work could usefully be done investigating the intricate linkages and cross-dynamics of this dual process during this period of change. Changes in the ideological climate appeared to be correlated with real shifts in

processes eventually led to a profit squeeze in the industrialist capitalist states' national economies, a profit squeeze that reflected the crisis of over-accumulation that the rigidity of the Keynesian-Fordist model of production had produced. Austerity measures adopted by states to resolve this crisis provoked widespread popular protests by citizens of these advanced capitalist states, resulting in a rapid increase in money wages. This process of clamp-down and associated mini-recession from 1970-71 was succeeded by a mini-boom from 1972-73 that proved to be the "final phase of the long postwar boom." (Wayton and Seddon 1994: 6) The US dollar devaluation of 1971, the oil-crisis of 1973-74 and the associated international recession of the mid-1970s signalled comprehensively the end of the post-war golden years of growth. The accompanying collapse of the Bretton Woods system and the OPEC oil crisis therefore produced a new turbulence and volatility into the major economies of the world in the 1970s and the 1980s. (Agnew and Corbridge 1995: 103) This increased volatility in the international environment was accompanied by efforts by manufacturers and various financial institutions to search out additional markets, and wider outlets for investment. (Hirst and Thompson 1996: 9) This search was also accompanied by an internationalisation of financial markets through market deregulation, and the increased abandonment of exchange controls. This period in the history of development thinking, a period characterised by Harvey as a change from Fordism to Flexible Accumulation (Harvey 1989: 141-172), witnessed a decrease in state intervention in economic production, a decrease influenced by institutions such as the World Bank and the International Monetary Fund.

The Birth of Structural Adjustment Programs

The growth of the Euro-bond and Euro-dollar market following the OPEC crisis in 1973 meant that enormous loans became available to Third World countries in the 1970s. The money re-entered circulation as it was lent, at low rates of interest, by many European banks to governments in the developing world in order to finance domestic development projects.⁴ The growing international economy of the 1970s, and the loans this enabled, thus saw the initiation, throughout the developing world, of

the structure and form of the international environment.

⁴ There were two major problems with this situation; first, borrower countries were becoming dependent upon on what were perceived as near endless flows of cheap credit with long maturities, secondly the banks were lending beyond the level of prudent financial acumen and they had little control of how the loans were being used. (Stallings 1992: 59)

numerous large-scale development projects. Since the loans went primarily to governments most of the development investments were made by state-owned firms, the result of this was an expansion of the public sector in much of the developing world. (Stallings 1992: 51). Between 1970 and 1982 Third World countries received an inflow of US\$480 billion, which amounted, subtracting interest payments, to an average of 1.7 percent of GDP per year over the twelve year period. However, the onset of the second OPEC oil shock in 1979-1980 spelt the end of this false boom, and led eventually to the international recession of the 1980s.

The advanced industrial countries responded to the onset of the second oil shock by raising their interest rates in order to combat inflation. The result of this for the developing world was an increase in the interest on their debt that they were supposed to pay back, at the same time as their non-oil export revenues stayed the same or decreased due to the decrease in the demand for primary products in the international market resulting from the higher international prices for oil. The onset of the subsequent oil crisis meant that many of the European banks that had been lending massive amounts of monies to developing countries called in their loans. On 13 August 1982, as a direct result of this chain of events, the Mexican Minister of Finance arrived in Washington DC with the announcement that his government could no longer continue to service its debt as per its original contractual agreement. A package was quickly put together to 'save' the Mexican economy but the failure of the Mexican government to service its debt saw banks react by discontinuing their 'voluntary' lending services. As many developing countries were expectant of, and dependent upon the continuation of the loan schemes to service their own debt repayment schemes the crisis in Mexico was inadvertently extended to other developing countries. In order to avert a massive international fiscal crisis a form of creditor cartel was set up. This cartel consisted of a number of large banks from the United States, Europe and Japan who grouped themselves into committees, one for each debtor nation, who were to oversee the debt management process of their respective country on behalf of all creditor institutions. (Feldstein et al 1987) In order for placate the creditors fear of defaulting each of these debtor countries also needed to have a stand-by arrangement in place with the IMF.⁵ In an attempt to resolve the

⁵ This concerted cartel approach by the creditors meant that the heavily indebted countries had very

crisis the creditor banks owed money by Third World governments were told by the IMF that only if they supplied additional monies to the creditor countries would the IMF agree to supervise the debtor governments' economic policies. (Stallings 1992: 65) In this way the banks' loans would be protected at the same time as the debtor countries were provided with a much needed influx of capital in order to service their debt repayment schemes. However, this scheme soon broke down when it was realised that the debt crisis was not just going to disappear in a few years as had previously been thought. The breakdown in creditor unity occurred as the large banks became increasingly annoyed at the lack of monetary support they were receiving from the industrial countries, while the smaller banks just wanted to cut their losses and run. The Brady plan – wherein the IMF continued to loan to countries in arrears to banks – also worked to undermine the international creditor cartel as debtor countries defaulted on service payments in the knowledge that the IMF would service their loans. (Stallings 1992: 65-66) The work of the IMF and the World Bank in the 1980s was thus primarily geared to a strategy that directed their lending towards ensuring the repayment of their donor countries debts to private creditors. However, as private banks increasingly pulled out of the developing country loan business the IMF and World Bank began to take up the slack. Thus, in the 1980s International Financial Institution's (IFI's) such the IMF and the Asian Development Bank began to replace private bankers as the suppliers of capital to the developing world. (Kahler 1990)

In order to protect their investments, the IFI's began in the late 1980s, to incorporate notions of conditionality into their loans, with the notion of conditionality being formally incorporated into the amendments of the Articles of Agreement of the IMF. Similarly, during this period the notion of conditionality became a feature of many other bilateral loan schemes as well, with the World Bank further developing the notion of conditionality to create Structural Adjustment Loans (SALs) and Sectoral Adjustment Loans (SEALs) in an effort to ensure a stable macroeconomic climate in its donor countries.⁶ It is thus generally agreed that the 1980s witnessed a dramatic

little opportunity in which to improve the terms which were offered. One way for this lack of choice by the debtor countries may have been avoided would have been the creation of a debtor cartel, but this never came to fruition. (Stallings 1992: 61; Tussie 1988)

⁶ Stabilisation policies of IFIs thus emerged in the 1980s due to a number of reasons; (i) the IMF increased its resources so that its loans became quite significant, (ii) private sources of finance dried up

change within the policy objectives of the IFIs, away from a focus on debt stabilisation policies and towards a form of policy which pursued deeper structural changes in debtor countries economic infrastructure. (Stallings 1992: 76) Accordingly there was a movement away from the use of World Bank disbursements for specific projects and towards broader structural adjustment loans.⁷

This movement by the IFIs towards a greater reliance on the operation of the free market in the achievement of developmental goals drew heavily upon the emergent neo-liberal school of thought. In this neo-liberal approach to development the state sphere was to be reduced to the minimum, and bureaucratic control was to be replaced by market mechanisms wherever possible.⁸ The early structural adjustment programs thus comprised policy prescriptions designed to combat inflation through the adoption of tight monetary policy in order to liberalise the operation of the free market. Due to the predominant belief that the free market was self-regulating and that once the effects of a economic shock had been mitigated the ‘invisible hand’ of the market would inevitably lead to economic growth and development, adjustment in this period was thus primarily geared to the mitigation of outside shocks such as an oil price increase or a drop in international agricultural prices. The adoption of these neo-liberal policy directives by the IFIs was widely known within the development community as the ‘Washington Consensus’ (Williamson 1990) Comprising a mixture of policies for getting prices right, liberalising trade and achieving macro-economic stability, these policies formed the basis of the objectives contained within the World Bank’s SAPs of this period. The unrivalled success of the East Asian economies in

in the wake of the Mexican debt crisis, and (iii) other creditors found it in their interest to reinforce the policies of the IMF. Whereas in the 1970s developing countries had been able to pick and choose their source of finance (hence other Banks had acted in competition with the IMF) the 1980s saw the IMF become, in some senses, a monopolistic international creditor. The IMF was thus, through the interaction of these various reasons, able to enforce stabilisation policies.

⁷ The ‘Berg Report’ (World Bank 1981) was one of the first policy statements by the World Bank which actually used the term Structural Adjustment in terms of outlining its emergent development strategy. Named after the main author of the report Elliot Berg, the report is officially known as World Bank Report (1981) *Accelerated Development in Sub-Saharan Africa* (Washington D C: World Bank).

⁸ Neo-liberalism as an ideology is derived in large part from tenets drawn from neo-classical economic theory. Based on the concept of rational individuals with perfect information making decisions which maximise their utility, neo-classical economics posits the existence of feedback systems which allow any inefficiencies within a system, be economic or political, to be selected against through a process of adaptation. The empirical realities of the modern economic and political world fall far short of this ideal however. The appeal of market solutions is that they apparently appear to minimise the need for regulatory institutions – increasingly however they have been shown to be inefficient in terms of realising the potential of positive externalities. (Kitschelt et al 1999)

the post-war period was claimed as a victory by this neo-liberal non-interventionist school. (Balassa 1981; Friedman and Friedman 1980; Gilder 1984; Linder 1986) Yet even in this ideology the necessity of the role of the state in the attainment of economic growth was accepted (North 1981: 20), but restricted largely to the protection of “individual rights, persons and property” and the enforcement of “voluntarily negotiated private contracts.” (Buchanan et al 1980: 9)

When excessive deflation occurred within developing countries in response to these balance-of-payments crises, however, questions arose as to whether or not these early structural adjustment programs were antagonistic, given that a key goal of structural adjustment programs, in particular, and development lending, in general, is that of increasing production and output whereas these earlier programs dealt only with issues of fiscal containment. So gradually over the period between 1985 and 1988 the adjustment programs came to be constructed within a context of expansion not contraction. These developments were accompanied by a dramatic theoretical shift in the sphere of the comparative politics of development.

The Development of the Statist and Developmental State Models

The late 1980s witnessed the emergence of an influential new body of literature which straddled the worlds of comparative politics and development studies. Emerging, in large part, out of the growing number of critiques of the established development paradigms of the 1970s and early 1980s, the new developmental paradigm argued that there was a need to ‘bring the state back’ into discourse on development. (Evans, Rueschemeyer and Skocpol 1985) Critical of the socially reductionist approach lauded by the then popular neo-Marxist and neo-Pluralist approaches, the statistes contended, that too much focus had been placed on the society side of the state-society nexus. (Alam 1989; Appelbaum and Henderson 1992; Haggard 1986, 1990; Johnson 1982; Wade 1990; White 1988) The inability of these earlier paradigms to explain the phenomenal rise of the East Asian economies in the 1980s was seen by the supporters of this new statist approach as proof that a strong, autonomous state was necessary in promoting successful economic development in the developing world.⁹

⁹ These new ‘statist’ theorists claimed for example that theorists in the dependency tradition had

These statist theorists argued that the autonomous decision making ability of the state had been the crucial variable in the success of the East Asian economies. The ability of the East Asian states to achieve a degree of autonomy, defined as the ability of the state to formulate policy independently from pressure from societal groups, was thus identified as the key factor in the shift from import-substitution policies and towards the more outward looking, export-focussed policies that had been at the base of the East Asian economic success. (MacIntyre 1994a: 4)

In the statist literature then, states were perceived to act on their own preferences, with those policy preferences being constrained largely by the state's own administrative and legal order. States were thus classified as strong, such that they were insulated from distributional pressures from societal sectors, and that they were sufficiently coordinated and coherent in organisational terms to allow for the effective implementation of state policy. (Doner 1992: 399) The behaviour of state officials was therefore analysed in terms of their own policy preferences rather than seeing them merely as tools of wider societal interests. In this statist tradition, emphasis was thus placed upon the degree of centralisation and extension of state power over society, and on the overall structure of the bureaucratic apparatus. This tradition borrowed heavily from Weber with his definition of state officials as careerists who identify closely with their vocation, and who were socialised into those views within the bureaucracy and hence only minimally influenced by wider society's interests.¹⁰ (Weber 1964, 1968) A state's ability to support markets and capitalist forms of accumulation therefore depended upon the bureaucracy being a coherent corporate entity through which the furtherance of corporate goals was seen as the best means through which individual members could maximise their own self-interest.¹¹ The statist argued, however, that the maintenance of this coherent sense of corporateness required that individual members be insulated from the demands of the surrounding

overemphasised international relationships to the detriment of domestic concerns and structures.

¹⁰ In Weber's view, a prerequisite of the efficient operation of capitalist markets was the construction of a solid, authoritative, administrative framework. In this view, rent-seeking behaviour (corruption) is a feature of earlier pre-bureaucratic forms of social organisation. The bureaucratic state, with its meritocratic civil service thus provided a suitable environment in which to foster economic development.

¹¹ Statists thus believe that the maintenance of political order, the creation of a stable legal order for market relationships, the use of macroeconomic policy (both fiscal and monetary) in order to curb inflation and dampen the business cycle and the financing of physical infrastructure projects such as roads and airports are important functions of the state.

society. This insulation was enhanced through the conferral of a distinctive status upon the members of bureaucracies. Statists also argued that to be effective in overcoming obstacles to development, states, while being 'strong' in the sense that they have the ability to make and implement policies, also had to be 'autonomous' in the sense of being able to ignore pressures from powerful interest groups. A state, in the statist tradition, therefore possessed both powerful political leadership as well as a trained technocracy in order to develop policy. Without this autonomy powerful interest groups would 'take-over' the state in order to promote their interests through the extraction of massive 'rents'. (Amsden 1979, 1989; Evans, Rueschemeyer and Skocpol 1985)

State versus Society

One of the chief early exponents of this statist theory in a non-East Asian context was Joel Migdal. Migdal (1988) argued that one cannot have a strong society and a strong state. The problem lay, he argued, in the realisation that state leaders must compete with local leaders for social control. Local leaders – whom Migdal termed 'strongmen' (1988: 33) – have their positions based in the current structures of society. The major struggle within societies, especially those with fairly new states, is thus whether or not the new state will be able to displace other organisations in society that make rules against the wishes and goals of state leaders. (Migdal 1987: 398) The important point for Migdal is that the state is only one institution among many that competes to exert control over society. Social structure, particularly the existence of numerous other social organisations that exercise effective social control, thus has a decisive effect on the likelihood of the state greatly expanding its capabilities (Migdal 1987: 397) Migdal's work therefore utilises a zero-sum conception of power, wherein a strong society necessarily means a weak state. In his work Migdal (1988: xiii) defined a state's capability as "the ability of state leaders to use the agencies of the state to get people in the society to do what they want." State capability was thus defined as the capacity of the state to perform tasks such as the regulation of social relationships and the extraction of resources. Strong states would be highly capable in completing these tasks while weak states would not. For Migdal state capability was linked to state autonomy, such that if the state was not autonomous enough it would be 'captured' by societal interests, and become little more than a vehicle for their them. His view, strongly typical of that characterised by

the statist school, can thus be summarised as a 'state versus society' viewpoint in which groups within society, including the state, constantly struggle with each other for dominance.

Criticism of this statist approach began, however, to emerge in the early 1990s. Criticisms stemmed from the fact that the statist interpretation did not appear able to adequately account for the importance of state capacity in the achievement of economic development. The statistes were thus accused of being too centred on the concept of state autonomy, thereby disregarding the influence of greater society on political outcomes. The writers in the state-market tradition had essentially ignored the fact that this relationship is itself embedded within wider civic relationships. In particular they were accused of being too concerned with leaders rather than the relationship between state and society, and of placing an inordinately large amount of theoretical weight upon state structures and political legacies in defining state action, with the result being that society, in their analyses, was all too often parcelled off as a redundant category. (Clark and Chan 1994; Doner 1992; Evans 1995; Moon and Prasad 1994; Remmer 1997; Weiss 1995, 1998; Weiss and Hobson 1995)

Bringing Society Back In

The development of these criticisms led theorists to the realisation that as both the 'state' and the 'market' are embedded within larger societies and cultures, social and cultural variables may well affect how states and market operate and, more importantly, how they interact to produce (or not produce) developmental trajectories. (Clark and Chan 1994: 339-340; Moon and Prasad 1994) Known variously as neo-statism or developmental state theory, this new paradigm provided an innovative linkage between political institutions and economic performance.¹² Instead of assuming a zero-sum relationship between government involvement and private cooperative efforts, the developmental state literature argued that active government and mobilised communities could enhance each other's developmental efforts. (Peter Evans 1997c) Development state theory, however, still owed much to its statist predecessor. Similarly to the statistes, the developmental state paradigm was based on

¹² The term 'developmental state' was first used by Chalmers Johnson (1987) in reference to the connections between the bureaucratic state apparatus and private business interests in Taiwan and South Korea.

the idea of a strong administrative state structure characterised by executive dominance. The success of the theory was also heavily dependant, especially in its earlier configurations, upon a high degree of bureaucratic unity and the political capacity to insulate economic decision-making and implementation from various contending political and social interests. (Moon and Prasad 1994: 360) However, while agreeing with the statist that the state plays a vital role in economic development the developmental state theorists disagreed with the statist claim that state autonomy on its own promotes state capacity. They insisted instead that it is precisely the connectedness of the state with society, rather than its autonomy, that was the reason behind the East Asian economic success. (Evans 1995; Weiss 1995, 1998; Weiss and Hobson 1995) The difference between the statist and developmental state schools of thought is thus a striking one.¹³ One of the most sophisticated models to emerge out of this particular theoretical tradition is that of the sociologist Peter Evans with his notion of 'embedded autonomy'.

Embedded Autonomy

In his original work Evans (1989, 1994) challenged the theoretical base of the statist with the argument that the existence of a meritocratic Weberian bureaucracy was not enough in itself to generate effective economic development. The state, he argued, must also have close ties to societal interests. In order to be effective it must be 'embedded' within the dense network of social relationships that compose civil society. The key to the effectiveness of this embeddedness is the existence of close ties between bureaucrats and the private sector in which, in line with the initial work of the statist, however, the bureaucrats retain their ability to formulate and act on their preferences autonomously. (Evans 1989, 1995) Embedded autonomy thus depends upon an apparently contradictory combination of Weberian bureaucratic insulation with intense immersion in the surrounding social structure. (Evans 1989: 574) However, neither of these two elements works by itself, a state purely embedded within the structures of wider society would be prone to takeover by predatory, rent-seeking social forces,¹⁴ while a state that was purely autonomous would lack both

¹³ Work by developmental state theorists has also served as a further basis for the refutation of the historical fatalism of the Dependency school. There thus are several 'pathways from the periphery' (Haggard 1990) that developmental states can follow, thus avoiding the structure of dependency situation that the neo-Marxist dependency school foretold.

¹⁴ Without state autonomy, embeddedness would thus degenerate into a super-cartel aimed merely at

sources of intelligence and the ability to rely on decentralised private sector implementation. Dense connecting networks without a robust internal structure would thus leave the state incapable of resolving 'collective action' problems and of transcending the individual interests of its private counterparts. (Evans 1995: 12)

These two characteristics of embedded autonomy enable the state to both seek and define long term developmental goals through information acquired from society in a co-operative manner, while at the same time social forces act to constrain the state's policy choices so as to prevent the capture of the state by predatory self-interest. Thus only when autonomy and embeddedness are combined can a state be called developmental. Having successfully bound the behaviour of actors to its pursuit of collective ends through both formal and informal networks, the state can then act with some independence in relation to particularistic societal pressures. This form of autonomy characteristic of the developmental state is, however, of a completely different character from the aimless domination of the predatory state.¹⁵ The autonomy of the developmental state is thus embedded in a concrete set of social ties which bind the state to society and provide institutionalised channels for the continual negotiation and renegotiation of goals and policies. (Evans 1992: 164)

When officials are embedded within concrete sets of social ties that bind the state to society they allow for the capacity of the state to be increased through their facilitation of institutionalised channels for continual and information sharing. Evans' notion of embeddedness thus encompasses both the informal networks linking bureaucrats and capitalists as well as the internal formal organisational characteristics of the bureaucracy that give it its independence. In a similar vein, Maxfield and Schneider

protecting its members and maximising their gains. Embeddedness is thus assumed to only have value in the context of a degree of autonomy of the state, in the absence of a coherent Weberian sort of administrative structure, embeddedness will almost certainly lead to clientalism. (Evans 1992: 179)

Zaire in the 1970s and 1980s is an example of this type of state.

¹⁵ A feature of development in Africa was the construction of predatory patterns of state leadership in which the resources of the state were used to build up domestic political support. This predatory behaviour was brought about by a combination of the frailness of the political legitimacy with which these state elites held power, combined with a weakness of the state's institutional resources. The development policies of these elites thus had effect of not so much of redistributing the profits of economic growth (if this did in fact happen) as much as it was increasingly concentrated in the hands of the elite ruling classes. (Petiteville 1998: 118)

Control of the state apparatus was vested within a small group of personally connected individuals. (Evans 1992: 149)

"The [predatory] state fails to provide even the most basic prerequisites for the functioning of a modern economy: predictable enforcement of contract, provision and maintenance of infrastructure, and public investment in health and education." (Evans 1992: 151)

The state is unconstrained by society, and is hence autonomous in the sense that it does not derive its goals from the aggregation of societal interests. "This autonomy does not enhance the state's capacity to pursue goals of its own, but rather removes critical social checks on arbitrary rule." (Evans 1992: 151)

(1997) argued that it is wrong in analyses of the developing world to simply equate state-business relations as corrupt forms of patron-client networks. Instead, they argue that the co-existence of cohesive and well disciplined business associations and a professional Weberian bureaucracy mean that state and business can work together synergistically in the achievement of economic development without collapsing into simple rent-seeking behaviour. The developmental state approach, particularly as exemplified in the notion of embedded autonomy, thus allows theorists to move beyond the zero-sum state versus society framework of earlier analyses and into a more realistic conceptual framework, a framework which is able to appreciate the intricacies of the often positive relationship between the state and society. This idea that the use of civic links can expand the 'effective' capacity of the state is thus the key conceptual variable in the developmental state literature, which can best be summarised as a state-in-society approach.¹⁶

State-in-Society

Evans's work on embedded autonomy demonstrated that the empowerment of social forces does not necessarily weaken the power of the state to govern society. In fact the development of the connectedness of the state with the social infrastructure may even enhance the capacity of the state to achieve its goals. The notion of 'Embeddedness' thus provides a solution to the problem of capacity which had plagued the statist. Embeddedness is necessary because government policies must respond to the problems of actors within society. The existence of a concrete network of external ties also allows the state to assess, monitor and shape private responses to policy initiatives, and by extending the state's intelligence it enlarges the prospect that policies will be implemented. Connections of the state to civil society thus become part of the solution rather than part of the problem.¹⁷ (Evans 1992: 179)

¹⁶ In its original formulation Evans (1989, 1992, 1995) acknowledged that the notion of embedded autonomy was concerned not with links between the state and broader civil society but rather with the specific links between the state and industrial capital. In *State-Society Synergy* (Evans 1997a) he dealt with this weakness by demonstrating that embeddedness does not necessarily only take the form of ties between the state and business elites, and instead demonstrating (as did the other authors in the book) that the notion of embeddedness could be successfully applied to ties between any group in society and the state in the successful achievement of developmental goals. The expansion of the notion of embeddedness to include a broader range of social groups thus allowed for the creation of a much more theoretically robust version of embedded autonomy.

¹⁷ While Evans (1995) had earlier claimed that a well-developed professional bureaucracy was an essential part of embedded autonomy this recent work by Chazan (1994) and Shue (1994) demonstrates that state-society empowerment can begin, in certain cases, on the side of civil society. In these cases

Connectedness thus means increased competence, not capture. (Evans 1995: 50) In this developmental state approach then, while it is accepted that state agencies have a degree of autonomy in the development of policy preferences, it is also argued that these same preferences are far more likely to be achieved if the state works with society rather than against it. In the developmental state literature power is thus no longer conceived purely in zero-sum terms. Instead, the literature argues that states and societies can combine synergistically to mutually empower each.¹⁸ (Evans 1997; Migdal, Kohli and Shue 1994) Interestingly enough, however, while this revolution was occurring in the theoretical sphere of comparative politics, a similar, and related, revolution was occurring in the realm of developmental policy.

Changes in IFI Developmental Policy

There has been a resurgence of interest, in recent years, in the development community in the notion of civil society and its potential for improving both political and economic governance in the achievement of developmental outcomes. (Cohen and Arato 1992; Hirst 1994; Putnam 1993) Development theory up until the emergence of the developmental state literature had largely marginalised the importance of informal norms and networks of social relationships in the achievement of developmental goals. Yet, recent work in both the developed (Gerlach 1992; Hamilton and Biggart 1988) and developing world (World Bank 1993) has shown that some of the most competitive firms, regions and nations are in fact grounded in precisely these forms of coordination and cooperation. Recent studies in sub-Saharan Africa and the Pacific, for example, have shown that improvements in non-state capacity can improve state capacity. (Bratton 1989; Taafaki and Oh 1995; Owusu 1997)

Empowering Civil Society

Michael Lipton (1991: 21) linked the failure of many structural reform programs to what he called the 'state-market dilemma'. In simple terms this dilemma revolved around the idea that in the early stages of economic development both state and

the development of a strong civil society played a positive role in helping the state overcome problems of parochialism and localised protectionism.

¹⁸ The notion of the developmental state thus opened up the realisation that the relationship between

market must increase in power. This process is, however, very much often a zero-sum situation wherein the growth of the state or market tends to weaken or subvert the growth of the other. In overcoming this dilemma Lipton has argued that the active use of the institutions of civil society – to provide a network through which information and the like may be exchanged by individuals without going through state or market channels – may act to circumvent, or at least inhibit, the possibly destructive effects of early state-market interactions. Similarly, Pierre Landell-Mills (1992) has argued that the empowerment of civil society and the systematic reconstruction of society through the empowerment of a variety of interest groups including community organisations, business associations and other women's groups could be the key to successful economic development and the achievement of 'good government.' Claiming that Africa would only emerge from its current difficulties if it progressively remodelled its institutions to be more in line with the traditions, beliefs and structures of its component societies Landell-Mills argued that "the nurturing of civil society through the development of its associational life will both deepen and broaden popular participation in, and control of, its institutions." (Landell-Mills 1992: 545) However, while theorists have argued since the early 1980s (Cleave 1980) that the harnessing of non-state resources increased the likelihood of a program of policy reform or implementation being achieved, explanations of the mechanisms behind these processes before the emergence of the developmental state literature had been rudimentary at best.

Improving Governance and State Capacity

In recent years there has thus been much debate within the development community about the topic of 'governance', as opposed to 'government'. While the latter is identified with the traditional system of political institutions, the former is connected with various types of self-government through networks of informal and formal norms. Governance is thus not only the sole province of governments as community organisations, business owners and church groups can all play significant parts. (Oh 1995: 9) This governance literature is thus characterised by a movement away from a

state and society could allow for the emergence of a positive-sum conception of power.

unilateral focus, where state and society are treated separately, and towards an interactionist focus, where the state is seen to act with society, although not always necessarily in concert. (Kooiman 1993: 35) Governance is thus concerned with “the institutional environment in which citizens interact among themselves and with government agencies/officials.” (ADB 1995: 2) This notion is itself intricately linked to the notion of capacity, as the capacity of the institutional environment determines the ability of governments to effectively implement policies for development and reform.

In the developmental community, state capacity has long been identified as a necessary aspect of successful programs of structural adjustment. Three dimensions of state capacity are especially crucial to the reform process, these being:

- Policy Formulation – the capacity to deal with the international dimensions of the policy environment – political, social, economic and technological;
- Policy Execution – the capacity to manage the ongoing policies and programmes in the country; and
- Management of Reform – the capacity to design, introduce and sustain capacity building programmes for the management of the affairs of government. (Corkery 1997)

Similarly, Joan Nelson (1988) has argued that there are three sets of inter-dependent factors which directly affect the political sustainability of an economic stabilisation effort, and by extension a program of structural adjustment. The three factors being:

- the strength of political leaders’ commitment to the program;
- the government’s capabilities; and
- the political response the program evokes from influential groups.

Thus, for the maximisation of conditionality and structural change key elites must be allied to the agent of change, be it an IFI or a bilateral aid donor. Elites groups generally find it in their interest to maintain the status quo unless they are sure that change will act to improve their current situation. Non-elite groups are also prone to be suspicious of change as the initial stages of growth often require that the general

population makes sacrifices. The task of initiating and continuing economic growth therefore requires careful coordination. Leaders must persuade both elites and non-elites that the fruits of this growth will flow down to them – and hence provide the impetus for societal groups to undertake the various restrictions and sacrifices needed in order to actuate economic growth.¹⁹ Consolidation of reforms is therefore most likely to be achieved where governments have constructed relatively sturdy bases of political support, encompassing major private sector representatives and beneficiaries within wider society, as well as having secured at least the acquiescence of the major political forces competing within the political system. Without such taciturn or definite alliances between politicians, elites and those most affected from the policy changes, reform attempts will necessarily falter. (Haggard and Kaufman 1992: 20) Political order in this sense is thus no longer conceived as something external imposed by the government or the state. Instead, political authorities work through, and with, a plurality of other actors and cannot be sharply distinguished from them.²⁰ (Larmour 1995a: 17)

The East Asian Experience

The World Bank Report *The East Asian Miracle* (1993) asserted that the state had played an important ‘market facilitating’ role in the development of the East Asian economies, in establishing (i) a good macroeconomic management (thereby providing a secure framework for private investment); (ii) banking policies which enhanced the banking sectors integrity as well as increasing national savings; (iii) an emphasis on

¹⁹ The World Bank thus concluded, in the East Asian experience anyway, that a major reason for the economic success of these economies was the establishment of specific mechanisms that operationalised the principle of shared growth - mechanisms including the provision of public housing in Singapore and Hong Kong and deliberation councils in Japan in order to demonstrate the reality of shared growth. (World Bank 1993: 188)

²⁰ In the organisational literature, three mechanisms of governance – markets, hierarchies and communities – are generally seen to explain the majority of cases. (Colebatch and Larmour 1993) Markets are defined as domains in which actors holding separate property rights in different resources engage in free and legally enforceable contractual exchanges. Hierarchies, in contrast, are defined as domains in which certain actors wield authority over others due the institutionalisation of property rights within a formal organisational framework to which both categories of actors belong. (Williamson 1985) Communities, on the other hand, are defined as formally or informally joined sets of individuals or organisations through which transactions are conducted on the basis of mutual trust and confidence sustained by stable, particularistic and legally unenforceable relationships. (Streeck and Schmitter 1985) In the modern world, the state provides the institutional context and legitimation through which markets and hierarchies exist. This, however, is not to say that these forms of organisation cannot exist outside the confines of the state, for they have done so before the existence of modern states, and continue to do so around the world. Communities, on the other hand, are much more independent of the state, although some forms of community, such as the nation, are intricately intertwined with the

education; (iv) fiscal regimes where price distortions were kept to a minimum; (v) policies which enhanced agricultural productivity; and (vi) an openness by the respective societies to foreign ideas and technology.²¹ (World Bank 1993: 5) The report concluded that state interaction in selective industrial targeting, accompanied by heavy investment in education and solid plan of macroeconomic management had led to economic growth and equitable levels of wealth distribution. (World Bank 1993) The World Bank's East Asian miracle project (World Bank 1993) thus marked a dramatic turning point for developmental thinking. It signalled the acceptance by the IFIs of the theoretical arguments put forward by the Developmental State school for the success of the East Asian tiger economies. Similarly, the World Bank's (1997) world development report *The State in a Changing World* argued that the quality of a country's institutions are as important a factor for economic development as are sound economic policies and human capital. (cf Granovetter 1985, 1992; Polanyi 1957) In this dramatic move away from its former purely free-market prescriptions the World Bank formally acknowledged with this report that polities such as the state, various other social networks of interaction and the actual act of governing are all embedded in a larger institutional context. Thus in real life the 'free market' is always bounded by sets of norms, values and mutual assumptions such that all economic process must be understood as socially embedded. (Granovetter, 1985; Granovetter and Swedberg 1992; Polanyi 1957; Scott 1995; Zukin and DiMaggio 1990) The report argued that state effectiveness can be improved, in part, if the state matches its role to its capabilities. What the state does should thus reflect the resources available to the state. More importantly, however, the report also argued that states can improve their capabilities by reinvigorating their institutions – which meant not only the strengthening of administrative or technical capacity, but also the strengthening of the connection of the state with other societal organisations and institutions. The release of this report thus heralded a dramatic shift in the thinking of the World Bank away from the more extreme forms of neo-liberal policies characterised by the Washington consensus and towards a more moderate form of developmental thinking, drawing heavily from the state-in-society approach expounded by the developmental state theorists. The *World Development Report 1997* (World Bank 1997) thus demonstrated the World Bank's acceptance that the quality of a country's institutions,

development of the modern state.

not just economic policies and human capital, determined developmental outcomes – a view made explicit in the presentation of the post-Washington consensus in late 1998.

The Post-Washington Consensus

The public acknowledgement of this move towards a new developmental policy paradigm known as the Post-Washington consensus signalled a decisive change in the way that the World Bank, and by extension the other IFIs, approached the issue of development. The Washington Consensus had advocated the use of a limited number of policy instruments – micro-economic stability, liberalised trade and privatisation – in order to achieve the relatively narrow goal of economic growth. However, macro-economic stability and long-term development require sound financial markets – and the Washington consensus, in its focus purely on restraining inflation and relieving budget deficits, could provide no more than a quick fix. The post-Washington consensus, by contrast, argued for a widening of the goals of development to include improved living standards as achieved through sustainable, equitable and democratic development processes. (Stiglitz 1998) The new consensus also argued for a concomitant widening of the policy instruments to be used in the attainment of these broader goals. Thus, Stiglitz argued “the key issue [in development thinking] should not be liberalisation or deregulation but construction of the regulatory framework that ensures an effective financial system.” (Stiglitz 1998: 14)

The post-Washington consensus therefore signalled a change in the thinking of the developmental community. It sent a clear signal that the pre-requisites believed to be necessary for a successful capitalist economy, and hence a successful program of structural adjustment, needed to be widened to include such values as trust and reciprocity, values which were themselves embedded in social institutions such as communities, networks and associations. (Granovetter 1985, 1992; North 1990; Polanyi 1957; Putnam 1993) The true basis of SAP's, in concert with such sentiments, should thus not be merely the manipulation of macro-economic aggregates, but should instead lead to the construction of an efficient regulatory system which can provide the contextual framework from which human development

²¹ The miracle talked about was the achievement of high levels of economic growth with equity.

can occur. The real significance of this document then was the realisation by economists, and by extension the IFIs, that governments need to govern, and that this can only occur if states work with the societies within which they are embedded.

Conclusion

According to current developmental thinking, the state requires both a degree of internal strength and a degree of embeddedness in societal structures in order to efficiently manage the process of economic development, and by extension the process of structural adjustment. The relationship between the state and civil society is thus potentially synergistic. Traditionally, state capacity has been defined in terms of the ability of the state to bring about political outcomes through the coercion or manipulation of wider society. In this respect state strength is traditionally viewed as existing along two key dimensions: capacity and autonomy. In general, the more autonomous the state the greater its latitude in setting policy goals, and the greater the capability of the state the easier these goals will be achieved. A high level of success in the ability to define and achieve political outcomes meant a strong state, whereas a low ability to conceive of, and then achieve political outcomes meant a weak state. In this approach then, state capability is defined in terms, highly reminiscent of early Pluralist approaches, such that lack of state autonomy would lead to the capture of the state by societal interests, thereby becoming little more than a vehicle for their interests. (Migdal 1988) Highly simplistic in its approach, this theoretical framework was open to critiques from a number of quarters, the most compelling of which is that this form of definition effectively positions the state in a zero-sum relationship with society wherein the existence of a strong state necessarily precluded the existence of a strong society. The realisation, however, that a high degree of connectivity between the state and wider society can actually improve the effective capacity of the state naturally leads to the conclusion that a high degree of social connectedness can actually positively enhance the strength of the state, a conclusion in direct contrast to the earlier 'state versus society' approaches. Similarly Hollingsworth, Schmitter and Streeck (1994) argue that networks and associations assume coordinating functions that decrease the 'load' on state officials and reduce market uncertainties. In this new perspective government performance can thus be perceived as much a function of

civic ties as it is a function of institutional design.²² (Larmour 1998: 10) Most Pacific Island cultures have a long tradition of gift exchange and property redistribution, ties of reciprocity which are at the base of the development of such civic connections. The cultural principles of reciprocity that undergird the developmental state in East Asia thus also undergird the 'traditional' social structures of Melanesia and Polynesia. To what extent this means that the state-in-society approach to the construction of developmental policy, as popularised by the developmental state theorists, is a valid basis for the construction of a successful developmental model for these areas is still to be explored. The following case studies thus provide an opportunity to explore the role that state-society linkages have had in the successful achievement of developmental objectives in the Pacific.

²² The positive sum interpretation of state-society interactions that this approach enables can be seen as a way of overcoming the apparent inefficiency and weakness of states in the developing world. Indeed this synergistic effect has meant that in some cases weak states within the developing world have been able to enact some extraordinary instances of economic reform. (Dauvergne 1998; Migdal, Kohli and Shue 1994)

CHAPTER THREE

STRUCTURAL ADJUSTMENT IN THE COOK ISLANDS

Crisis Leads to Reform

Comprised of fifteen islands, the Cook Islands are situated in the middle of the Pacific Ocean between Tonga to the west and the Society Islands to the east. Like many other South Pacific countries, economic development in the Cook Islands has been hindered by a number of factors including a lack of readily exploitable natural resources and geographical isolation from foreign markets. Yet despite such impediments to development, the economy of the Cook Islands expanded at a rate of about 6 percent per annum throughout the 1980s and early 1990s due, in large part, to good performances in the tourism industry. This high rate of growth, combined with the high percentage of labour employed by the Public Sector and the accessibility of aid loans from foreign governments, meant that the population of the Cook Islands enjoyed the highest standard of living in the Pacific Basin. Throughout this period the Cook Islands government under the leadership of the Cook Islands Party (CIP) promoted a modified form of Keynesian thinking, where big government was seen as a necessary conduit for the circulation of money throughout the economy.¹ In line with this form of economic thinking, large monies were invested in domestic 'think big' projects such as NZ\$15 million on the construction of the Sir Geoffrey Henry Cultural Centre and NZ\$20 million on the construction of a new four-star hotel, the Vaima'anga Resort. As early as 1991, however, regional institutions had begun to question the ability of the Cook Islands to maintain such large rates of capital expenditure and continue to manage its growing debt obligations. (Brown 1991: 68-69; Keith-Reid 1991: 16-19) Signs were becoming apparent in the early 1990s that there was a growing need to both reduce the size of the public sector and to encourage the growth of the private sector in order to expand the country's economic base, if the Cook Islands wanted to continue to maintain its high domestic standard of living.

¹ In fact even after the onset of the fiscal crisis of 1996, the then Prime Minister Sir Geoffrey Henry argued that the removal from employment of large numbers of the Cook Islands population from the public service would not help the economy and would in fact lead to the initiation of a recessionary spiral due to a large sector of the Cook Islands purchasing community ceasing to spend. (Dreaver 1996: 22)

(ADB 1994: 171-172; ADB 1995c) The onset of a recession in 1994 seemed to confirm these fears.

The 1994 recession resulted from a number of endogenous and exogenous factors including, amongst other things, a drop in tourist numbers, a reduced level of confidence in the domestic currency following the release by the government of large amounts of unbacked currency, and a general drop in economic confidence following the Letters of Guarantee scam.² (Crocombe and Crocombe 1996: 174; Wishart 1995) During 1995 the decline in revenue associated with the recession continued unabated, with the Cook Islands officially entering a state of recession in the second quarter of that year. Indeed, output continued to decline in almost all sectors throughout this entire period. However the reduction in revenue over this period was not matched by a reduction in expenditure. (see Figure 3.1) The reason for this slow decline in expenditure can be traced to the continued rise in salaries, wages, grants and welfare payments paid out by the government over this period, which amounted to 83 percent of total government expenditure by March 1996. (MFEM 1996: 1) Rather than initiating funding cuts or tax increases the Cook Islands government responded to the country's economic downturn by 'borrowing' funds from government-owned entities and government pension funds.

² A flow on effect of the Cook Island governments attempts to mediate the effects of the recession was the June 1994 reversion back to the New Zealand dollar as the sole monetary unit. An attempt by the Cook Islands government to relieve fiscal pressure through the release of an increasing amount of unbacked currency had brought the government under pressure from domestic exporters and banks – pressure that forced this reversion back to the New Zealand dollar in order to salvage business confidence.

Government Revenue and Expenditure

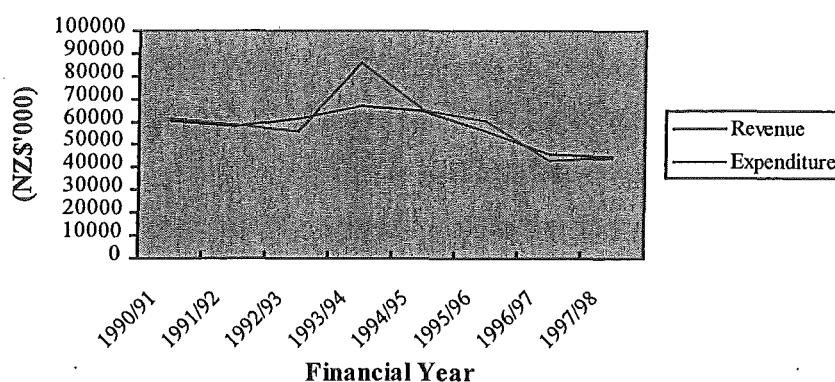


Figure 3.1. (Source: Cook Islands Statistics Office)

The country's worsening financial situation led the Cook Islands government to seek advice from the Asian Development Bank (ADB) in order to help resolve the continuing deterioration of the country's economy. A June 1995 fact finding mission by the ADB identified the existence of a number of key structural problems within the Cook Islands economy that had contributed to the deleterious effects of the 1994 recession.³ As a result of extensive talks a Memorandum of Understanding (MOU) was thus signed in June 1995 between the Cook Island government and the ADB which enabled the bank to finance a reform program of in-depth restructuring and capacity-building to begin in March 1996.⁴ However, an ADB Country Programming Mission in December 1995 raised concerns that, while the earlier MOU had identified key strategic objectives that needed to be addressed in the medium to long term, a pressing need remained for something to be done in the immediate future concerning debt and other fiscal constraints if the country's worsening economic situation was to be abated.⁵ (ADB 1995b) Yet, before any action could be taken, the concerns of the latter ADB fact finding mission were confirmed when, in March 1996, it became apparent that the Cook Islands was facing a severe fiscal crisis, although the full extent of the problem was unclear at that time due to serious weaknesses in the public

³ These problems included a crowding out of the private sector by government and the existence of inadequate public accounting systems.

⁴ The Memorandum of Understanding (MOU) which emerged from this mission provided the foundation for the later Economic Reform Program (ERP). (ADB 1995a)

sectors budgeting and accounting systems. Over NZ\$120 million in debt and barely able to maintain payments of the fortnightly public payroll, the Cook Islands government moved in March 1996 to resolve the immediate fiscal crisis through the adoption of a program of reform aimed at reducing debt levels and stabilising its financial operations in the short-term – with the long term goal being the total restructuring of the Cook Islands economy.⁶ In order to help alleviate the immediate fiscal crisis all overseas diplomatic posts, except that in Wellington, were shut down and funding for planned international events was reduced or cancelled. Plans were also introduced at that time to sell off a number of government assets in an attempt to reduce government non-personnel costs. These early stages of reform prompted the Ministry of Finance and Economic Management (MFEM 1996) to issue a report in an effort to predict potential outcomes of a major reform program. The report envisaged that structural reforms would lead to an increase in subsistence food production by the people displaced from the cash economy by the reform program. The surplus production of food from this process would then enter the market, thereby acting as a domestic substitution for imports. The report also argued that a possible increase in migration levels of people from Rarotonga to the outer islands could also occur. The report argued, that in the short term at least, there was more than likely going to be an increase in the numbers of Cook Islanders migrating to New Zealand and Australia, although the report argued that in the medium to long term this migration effect may be reversed, especially in light of a growing Cook Island economy in the near future.

Causes of the Crisis

The main cause of the crisis appeared to be due to a chronically oversized and unproductive public sector which had crowded out the private sector.⁷ (Wichman 1999) There were several reasons why the Government payroll had become so large over the years. On the Outer Islands, for example, the public service payrolls became the main source of monies in the communities, but this continued resource allocation depended upon the granting of political favours. (Rasmussen 1999) Positions were

⁵ Indeed, rising concerns over shipping caused Cook Island importers and traders to form an Importers Industry Council within the Cook Islands Chamber of Commerce in February 1996. (CIN 7/2/1996: 1)

⁶ The arrears owed by the Cook Islands government included loan repayments, funds borrowed by the government from the Cook Islands Savings Bank, amounts owing to donor funded aid projects and sub-loans diverted from sinking funds.

⁷ The declining activity of Cook Islanders in the Agricultural sector over the 1980s and 1990s provided clear evidence of the crowding out of the Private Sector by the Public Sector.

thus often created to ensure electoral support. Political and family patronage can thus be seen as the main engine behind civil service growth in the pre-reform area. Similarly, various protectionist policies of earlier governments had resulted in a private sector which was more import-orientated than export-orientated and was heavily dependent upon government expenditure – both directly and indirectly – through the consumption expenditure of people employed by the public sector. (MFEM 1996: 2) By 1996 the private sector was inefficient, heavily burdened by tax and kept afloat largely through artificial protection measures including an extensive framework of price controls and tariffs. The emergence of the fiscal crisis in 1996 can also be partly traced back to a long history of fiscal mismanagement. Government budgetary statistics were traditionally compiled on a cash accounting basis and as times grew hard these accounting practices became increasingly murky. In order to maintain fiscal balances the government resorted at various times to less than transparent means of fiscal management, including: shifting transactions between budgeted and off-budget accounts, deferring payments to employees, creditors and suppliers and even spending foreign currency assets that were supposed to back the circulation of the domestic currency. This occurred despite the supposed existence of legal requirements, including parliamentary scrutiny, which were meant to safeguard the accounting of public funds. The breakdown of the checks and balances that normally govern public finances in a parliamentary democracy can be identified as a key reason behind the fiscal crisis in which the Cook Islands found itself in 1996. The inadequate state of the country's public accounting systems had allowed government overspending to continue long past its point of sustainability. Over the three-year period from 1995 to 1997 real GDP had contracted at an average general rate of about 3 percent, yet throughout 1995 and early 1996 high levels of government spending had continued unabated. (See Figure 1.) The fiscal and economic crisis thus revealed both major structural problems in the Cook Islands economy, as well as serious weaknesses in public financial and economic management systems

The Reform Program

Path to Recovery – The Reform Agenda

Facing a severe economic and financial crisis the Cook Island government presented a report to bilateral and multilateral aid donors at an ADB Consultative Group Meeting

in Suva in early 1996 outlining a possible reform agenda focusing on: Public Sector Reform; improvements in financial measurement; and measures to promote Private Sector led economic growth. The document produced, entitled 'Path to Recovery – The Reform Agenda', outlined the economic reform program that attainment of these objectives entailed. Once presented, the report occasioned wide international support for the reform program. (Consultative Group 1996; New Zealand Government 1996) Following the meeting in Suva another ADB mission visited the Cook Islands, this time to help prepare an action plan for the proposed bank loan. Working in conjunction with representatives from the ADB, the Cook Islands government developed a program to restructure the economy. These objectives, with the help of the ADB and the NZODA, were then transformed during the latter half of 1996 into an Economic Restructuring Program (ERP). Involving three key objectives, the ERP sought to radically alter the role of the government in the Cook Islands economy, in aiming to:

- i) achieve and maintain macroeconomic stability;
- ii) promote private sector-led growth; and
- iii) develop strategies to alleviate social hardships and minimise economic restructuring risks, especially for target groups. (ADB 1996a: 7)

The loan to fund the restructuring program outlined in the ERP was to be released over a one year period in two tranches following the fulfilment of various conditions such as the maintenance of a balanced budget, the sale of assets and the introduction of various pieces of new legislation ensuring transparent financial management practices.⁸ (AusAID-NZODA 1997: 10)

ERP Objectives

The Economic Reform Program (ERP) sought to facilitate the transition of the Cook Islands economy from one in which the public sector was dominant, productivity was low and market signals were weak, to one which was led by a competitive and growth-orientated private sector. Importantly though, the attainment of these objectives were themselves nested within a concern to limit the negative social effects

that could arise from the reform process. Closely modelled on New Zealand's experiences (ADB 1998) the reform process entailed a complete redefinition of the state's role in the economy accompanied by a concurrent transformation of the key decision making structures of the Cook Island state (Root 1996: 2), a commitment made clear in the publication of the key reform document 'Path to Recovery: The Reform Agenda.'

Priority in the ERP was given to the reduction of the public service. The goal of the Public Sector reform program was to create a more efficient and effective Public Sector with clearly defined goals and objectives. The first phase of the reform program was thus to consist of a substantial down-sizing of the public sector, extensive cut-backs in non-personnel spending by government and the introduction and implementation of measures to restore fiscal responsibility and discipline in the Government's budgetary operations. The public sector downsizing was expected to release much needed resources to the private sector at the same time as a policy environment was created that enabled private investment and encouraged employment creation and export-led growth. In constructing the ERP the realisation was made that not all sectors of the Cook Islands economy were suited to export-led growth. Three key sectors, were however, earmarked as having high potential to expand export markets enough to turn the economy around. The three sectors were: Agriculture; Marine Resources; and Tourism. Growth in these three sectors were thus included as key objectives of the reform process.⁹

⁸ Funds from the loan were to be used to retire short term liabilities to domestic private sector creditors, to promote business ventures and to inject equity into the Cook Islands Development Bank.

⁹ The ERP itself consisted of a matrix of 110 objectives broken down into three larger sub-groups, these being: Public Sector Reform; the Promotion of Private Sector Growth and the maintenance of Social Equity and Sustainability. These sub-groups were then further broken down into sub-goals, with each sub-goal comprising a number of the 110 policy objectives. For a list of these sub-goals see Appendix One: Cook Islands ERP Objectives. For a full list of the 110 policy objectives of the ERP consult the Cook Islands Program completion report ADB (1998). The macroeconomic reforms were thus planned to involve extensive improvements in public sector financial management, the overhaul of the national tax system and the adoption of prudent debt management policies (including debt retirement, re-financing and re-negotiation policies with creditors). Similarly, the encouragement of private sector-led economic growth required a complete redefinition of the government's role in the economy, the removal of financial and economic practices which stood in the way of the operation of

The Initiation of the Reform Process

The actual initiation of a program of stabilisation and reform pre-dated the creation of the ERP. In an attempt to stabilise their steadily deteriorating fiscal position the Cook Island government had already engaged on a number of fiscal cut-backs, some of which, such as the closing of the majority of the country's consulates, have already been noted. Thus, in March 1996, in the wake of the fiscal crisis and, in an attempt to further reduce fiscal pressure, the Cook Islands government announced an immediate temporary 15 percent pay cut across the entire public service, effective immediately.¹⁰ While this evoked some initial concern within the Public Service Association (PSA) the realisation of the extent of the fiscal crisis helped assuage the PSA's resistance to the reforms. The PSA was thus actually in support of the reform process right from the very beginning. (Vaiimene 1999) In the national summit held in March 1996 the PSA had helped draft the 'Public Service 2000' document – a document in which it was agreed that it was in the best interests of the country to reduce the public service by over 1000 people over the next four year period. The PSAs 'Public Service 2000' concept entailed an orderly reduction of the public service coupled with a simultaneous increase in the skill level of the remaining employees. Under the ideals of 'Public Service 2000' the number of public servants would thus be gradually reduced over a four year period with those individuals phased out of the public service being picked up by the private sector. Thus, while the Public Service Association supported the governments reform program they nonetheless argued that the downsizing of the public sector should be accompanied by a corresponding growth in the private sector.

The wider Cook Islands community was also involved in the reform process right from the beginning through national retreats comprising representatives from the government, public service, private sector and the wider community.¹¹ Following in the wake of the fiscal crisis, two such national retreats were held on 4-6 March and 12

market forces, and the creation of a stable regulatory environment that encouraged investment by the private sector.

¹⁰ Down-sizing of Cabinet was aired as an alternative to the 15 percent pay cut for government employees by senior Cook Island Party officials but nothing ever came of this idea. (CIN 4/3/96: 1)

¹¹ This involvement was widely lauded by the Donor community as a welcome initiative, both in mediating the adverse social impact of the reforms and in creating a high degree of ownership of the reform process by the Cook Islands population.

March 1996. Specific recommendations made at the retreats were used as the basis for the creation of the 'Path to Recovery' document produced by the Cook Islands government for the Consultative Group meeting in Suva.¹² Many of the Cook Islands Churches also played a vocal role in the development of the reform process.¹³ In March 1996 when calls began to be heard for the Prime Minister and Cabinet to step down, a large number of the country's churches rallied to the government's aid. Organising prayer meetings, and paying for radio and newspaper advertisements various churches, particularly the Apostolic church, reminded people that they had received help from the government and now it was time for them to help the government.¹⁴ Similarly, the impending bankruptcy of the government galvanised the Private Sector into supporting the proposed reform measures of the ERP (Root 1996: 6) although certain elements within the private sector initially opposed the reform process. Those who initially opposed the reform process were those who were dependent upon the old pre-ERP system, however, when they realised the extent of the government mismanagement of the economy and the need for the enactment for reforms they too lent their support to the reform program. (Porter 1999)

Legislative Reforms

Amongst the first of the ERP reforms to be enacted was the passage of a key piece of legislation – the Public Service Act 1996. Passed on the 31 May 1996 the Public Service Act 1996 established the basis for the civil service reforms. The intent behind the enactment of the Act was to free senior managers from undue political interference. This was achieved by clearly defining in legislation the powers and

¹² The outline consisted of seven key headings, these being:

- Reducing Government's non-personnel costs;
- Reducing Government's personnel costs;
- Privatisation of Government functions;
- Mobilisation of revenue;
- Revitalisation of the Tourism sector;
- Revitalisation of the Agricultural sector; and the
- Mobilisation of Marine resources. (MFEM 1996: 7-10)

¹³ The period immediately before and during the reforms also witnessed the growth of membership of US-derived fundamentalist, evangelical churches (characterised by some commentators as a move towards 'quick fix' religions). (Crocombe and Crocombe 1996: 178)

¹⁴ The reason behind this vocal support for the government of the day can be attributed to the long history of collusion between the state and the churches. Church buildings would be constructed by government workers, with government equipment, and even sometimes with government monies. The unspoken price behind all of this being collusion. (Crocombe and Crocombe 1997: 224-225) By 1999, however, even the churches were questioning the continued rule of the Cook Islands Party with some church leaders vocally airing their intent to act as a social watch-dog over the conduct of the Prime Minister. (R. Crocombe 1999)

responsibilities of Heads of Ministries (HOMs), and devolving the power and responsibility to staff and manage their departments to the HOMs in order for them to achieve clearly defined outputs as agreed to in their yearly performance contracts. Under the auspices of the Public Service Act HOMs now sign a performance budget with their minister and are thus directly responsible for the budget and outputs of their departments. In real terms this means that the HOMs are able to draft their budgets based on output delivery and the resources needed, including staffing levels, to achieve those outputs. The Act also led to the reduction of the former 52 government ministries to 22 and the re-appointment of the HOMs on a competitive basis. The wide-scale round of redundancies was also accompanied by a merging of government departments in attempt to increase efficiency and limit overlap, thus formerly separate departments such as Immigration and Customs were merged into one new functional unit. Similarly, following the restructuring of the Public Service an executive review committee was set up to assist in the selection process for HOM's. The selection process was designed to be open and fair with the committee stating that if the government chose to ignore the recommendations of applicants forwarded to them and make political appointments then the committee would not take the blame for this. In the first round of final selections involving 12 departments, all HOM's selected by the Minister's were people whose names had been forwarded by the committee, although some of the appointed people were not on the 'preference' list originally put forward. In the second round of selection for the remaining three positions, however, some political manipulation did occur as the people appointed for the Departments of Justice and Education were not on the list forwarded by the committee for selection. (Okotai 1999) The implementation of the Act also meant a reduction in the role that the Public Service commission played since it no longer held the power of employment. However, while the Public Service Act devolved power away from the Public Service Commission for general hiring and firing of Public Servants, the commission still monitors the performance of the HOMs. The Commission is now primarily directed towards a more advisory role over issues of human resource development rather than the specific human resource management role that it played in the pre-reform era.

Additionally, in June 1996 the Cook Islands government enacted the Public Expenditure Review Committee and Audit Act thereby establishing the Public

Expenditure Review Committee (PERC) and the office of the Public Expenditure Review Committee and Audit (PERCA). The main function of the PERC committee – composed of two lawyers and two accountants drawn from the Private Sector and appointed by the Prime Minister – was to act as a watchdog organisation ensuring adequate public accountability.¹⁵ Its primary function was thus to assure both transparency and accountability in the operations of the country's Ministers and HOMs. The committee has broad-ranging powers to investigate any civil servant dealing with public funds and make official reports to parliament and the Minister of Finance regarding the outcome of their investigation. Replacing the older Audit Office the PERCA office, while continuing to fulfil its earlier functions (as set out under Article 71 of the Cook Islands Constitution), has also been mandated to investigate charges of misappropriation of government funds. The enactment of the PERCA Act thus allows for an independent review of the government's financial administration while simultaneously strengthening public expenditure review and audit arrangements.¹⁶

The last of three key pieces of ERP-derived legislation to be enacted by the Cook Islands government in 1996 was the Ministry of Finance and Economic Management (MFEM) Act. Enacted on 26 July 1996, and closely modelled on the New Zealand Fiscal Responsibility Act, the MFEM Act provides legislative force to the promotion of fiscal responsibility in government spending in requiring government to pursue policies which promote revenue predictability. In presenting the budget, for example, the Cook Islands government must now present fiscal limits that shall apply to current and future financial needs. Any departure from a balanced budget must therefore be explained. The Act also led to the creation of the new Ministry of Finance and Economic Management to oversee the day-to-day running of the country's economic environment. The MFEM Act also introduced stringent requirements on financial and economic policy construction and implementation. Through the introduction of

¹⁵ The PERC committee members do not hold any other public office and are independent of, though formally accountable to, Parliament. The committee has been operational since July 1997.

¹⁶ The PERCA system has already proved its worth in maintaining accountability in the public sector a number of times already. PERCA investigations into allegations of impropriety and misuse of funds into two Ministries have led to the suspension of one HOM and the dismissal of another. (Parliament of the Cook Islands 1998, 1998b) Similarly improper accounting practises has led to the investigation by PERC of the operation of the Transition Service by a high level public servant. (Parliament of the Cook Islands 1998a) How effective PERC's powers actually are in Parliament is however a question that will only be answered over time.

standard commercial accrual accounting processes and the creation of a national balance sheet, the Act has thus acted to increase both accountability and transparency within the Cook Islands public sector. Requiring the development and publication of clearly defined financial policy the Act establishes a commitment to fiscal responsibility. Detailing the accounting practices to support this objective the Act requires the Cook Islands government to state what it will be involved in, how it will allocate its resources and what outcomes it expects to achieve. Each of these objectives must be made public on a rolling three-year basis. The key attribute of the MFEM Act is thus that it requires the Government to maintain operating expenses within the limits of the Government's current internal revenues until debt levels are reduced. Specifying in detail the process through which budgets are to be formulated the Act forces the Government to publish statements of its economic and fiscal position and future strategy in advance of budgets being drawn up. The MFEM Act strengthened treasury fiscal controls, mandated balanced budgets on an accrual basis and outlined standards for more transparent fiscal reporting. The budgetary process is now much more transparent, with the PERCA Act providing the legislative power to maintain this transparency and accountability within the public sector.

Another aspect of the reform program which was dealt with in the first phase of the reform process had to do with changes in the way in which government accounts were dealt with. Over the period of a year from 1995 to 1996 the Public Service was introduced to a new, output-based budgeting system, moving away from a cash accounting system and towards an accrual system similar to that used in New Zealand.¹⁷ The Cook Islands government adopted these new output based budgeting and accrual based accounting systems on July 1 1996 in tandem with the introduction of statutes which delegated greater budgetary responsibility and accountability to the HOMs through performance contracts. The introduction of this new system was thus heavily intertwined with the passage of the three key legislative acts enacted during 1996.

Redundancies and Restructuring

The initial tool of the restructuring process was to be the reform of the public sector and, as noted previously, the publicly agreed upon document 'Public Service 2000' set out a timetable whereby these reforms were take place. The severity of the fiscal crisis, however, led the government to realise that three years would be too long and that the cuts would have occur within a one year period. While public consultation had been a defining point of the reform process right from its inception, only a select few knew the full extent of the fiscal crisis. (Epati 1999) Thus when the Cook Islands government approached the PSA with plans to downsize they were met with resistance at first as the governments plan for downsizing entailed retrenchment at a greater rate than the PSA thought equitable. Once the government explained the full extent of the fiscal crisis to the PSA, however, they became more receptive to the need for restructuring and downsizing – although with the added proviso that measures should included in the reforms that would prevent any future politicisation of the public service.¹⁸ (Root 1996: 6) In contrast to the immediate retrenchment and redundancies that the government had called for, however, the PSA brokered a deal wherein less people were made redundant immediately and government personnel took a 50 percent cut in pay of the period May and June 1996 on the belief that the extra 50 percent would be paid back later in the year when the immediate financial crisis was over.¹⁹ (Vaiimene 1999) Ensuing public sector retrenchments thus occurred at an unprecedented pace, with years of reform condensed into a matter of months. The most dramatic phase of the entire reform process thus occurred over a period of three months in late 1996, with the majority of the job losses in the public service occurring within the three month period from July to November 1996. The downsizing of the Public Service operated within two clear domains. The retirement of retirees, and those people eligible for early retirement, and those people who were not due for early retirement. Those eligible for retirement were paid their normal retirement entitlements which averaged about NZ\$3 500 each. Those who were not eligible for retirement were processed through the office of the Transition Service in an attempt to re-skill them such that they could efficiently transfer from the Public

¹⁷ Additional assistance was provided by the New Zealand Audit office in the implementation of the necessary standards and procedures required for the introduction of an accrual accounting system.

¹⁸ Whilst legislation such as the MFEM Act and Public Service Act were enacted towards the achievement of this aim, only time will tell if the civil service will once again become highly politicised.

Sector to the Private.²⁰ Phantom workers were also removed from the payroll. Throughout the Cook Islands a total of 1 445 public sector jobs were lost, however, while Rarotonga lost 757 jobs (44.5%), the Northern Group lost 207 jobs (53.7%) and the Southern Group lost 480 jobs (61%). (Corydon Consultants 1997: 49) The Outer Islands were thus hit hardest by the reforms. (see Table 3.1)

**Geographic Breakdown of Public Sector Downsizing
(June 1996 – June 1997)**

	June 1996	June 1997	Jobs Lost	% Reduction
Cook Islands	2883	1438	1445	-50
Rarotonga	1699	942	757	-45
Aitutaki	284	114	170	-60
Mangaia	192	76	116	-60
Atiu	143	54	89	-62
Mauke	144	45	69	-61
Mitiaro	64	28	36	-56
Manihiki	95	46	49	-52
Penrhyn	137	54	83	-61
Rakahanga	45	21	24	-53
Pukapuka	102	53	49	-48
Nassau	6	4	2	-33
Palmerston	2	1	1	-50
Suvarrow

Table 3.1. (Source: Corydon Consultants (1997) and Wilkinson (1998))

Mediating the Reform

The PSA attempted to help manage the retrenchments in a way so as to soften the impact of the reforms on their members, but the magnitude of the reforms meant that some social hardship was unavoidable. (Vaiimene 1999) A New Zealand Overseas Development Aid (NZODA) initiative, however, did much to mediate the social impact of the reforms.²¹ This assistance came in the form of a transition agency

¹⁹ The deferred wages were paid back by December 1996.

²⁰ The transition package included:

severance payment of up to three months' salary or wage paid in fortnightly instalments; and re-training courses to up-skill the participants in areas such as budgeting and small-business acumen.

²¹ The New Zealand government provided focused development aid throughout the course of the reform process, although levels were kept to a minimum as a key objective of the reforms was to

which was set up in order to alleviate the immediate impact of the mass redundancies associated with the Public Sector reform program and to help facilitate the movement of these former Public Sector employees into the Private Sector. The NZ\$7.4 million of funding provided by the New Zealand government specifically for this transition process went towards providing financial assistance, credit facilities, retraining, business advice and personal counselling for retrenched personnel – representing a social safety net provision for those retrenched during the reforms. As such, the importance of the Transition Service can not be underestimated as the support it provided was important to the success of the reform process. (Wilkinson 1998: 12) The Transition Service was set up in September 1996 and following the completion of the majority of its goals, it was disbanded in June the following year.²² During this initial period of reform lasting from about March to September 1996 ten assistant ministerial positions were also eliminated. (ADB 1999a: 29) Apart from this initial move, however, no political reform was undertaken at any stage of the reform, although later calls for the initiation of large scale political reform later became quite strident.

The Initiation of the Second Phase of the Reforms

A five point economic strategy was released by the Cook Islands Government in September 1996 outlining the ways in which the further goals of the ERP were to be achieved. The key objectives of the reform process that the strategy paper noted were:

- 1) Public Sector Reform;
- 2) Strengthening Financial and Economic Management;
- 3) Stimulating Private Sector-led growth;
- 4) Reforming the Lead Sectors (Agriculture, Marine Resources and Tourism);
and
- 5) Achieving Sustainability and Equity Issues.

reduce the economic dependency of the Cook Islands on the New Zealand government, especially in terms helping fund recurrent budget deficits.

²² Continuing New Zealand Overseas Development Assistance (NZODA) has focused on management training for senior Civil Servants, and the creation of opportunities for continued Private Sector growth such as funding for the creation of a small business centre.

A number of these processes, such as public sector reform, were well underway by this stage whilst others, such as the stimulation of private sector growth, were still to be initiated. The second phase of the reform program that was announced in September 1996 thus involved, amongst other things: the sale of public assets; the retirement of public debt; an improvement in the policy environment to promote private sector-led growth in income generating sectors; and the creation of a reserve fund for investments in social sectors and the management of other risks. This new phase of reforms were intended to consolidate the progress already made by previous reforms by helping create an environment to promote more sustainable growth. In timely fashion, the initiation of the second phase of the reforms coincided with the 2 October 1996 release of the first loan tranche of US\$3 million from the ADB for the ERP. The achievement of the eight reforms of the second phase would then lead to the release of the second tranche of the loan in July 1997.²³

Continued Community Involvement

The wider Cook Islands community was continually involved in the evolution of these reforms. In late 1996, in an attempt to institutionalise the consultative process, the National Development Council (NDC) was established. Comprising eleven community members representing the private business sector, non-government organisations and churches, the creation of the NDC was a key mechanism in the facilitation of consultation of the reform process at the national level.²⁴ The NDC was created to review government legislation and national budgets to make sure that they

²³ The eight conditions to be fulfilled by the Cook Islands government to enable the release of the second tranche were:

- compliance with the Finance and Economic Management Act;
- the drafting of a Public Sector Investment Program acceptable to the ADB;
- the enactment of amendments to the Income Tax and Turnover Tax Acts;
- the enactment of the Act establishing the Development Investment Board;
- the completion of an agriculture policy and strategy statement;
- the completion of a marine resources policy and strategy statement;
- the completion of a tourism policy and strategy statement; and
- the decentralisation of a large measure of political and economic power to Vaka and Island Councils and where appropriate village-level bodies.

The second tranche of US\$2 million was expected to be released on 31 July 1997 but a number of factors meant that the loan was released slightly later on the 29 September.

²⁴ Comprising representatives from the churches, NGOs, the private sector, youth, women and traditional leaders the NDC met to consider issues and relevant legislation as well as annual budget appropriations to the various ministries.

were in line with the spirit of the reform process. Throughout the remainder of the reforms the NDC thus played a vocal part, mediating government expenditure and scrutinising government legislation. Another group which played a key part in the reform process was the Cook Island Chamber of Commerce (CICC). Made up of members of the Cook Islands private sector, the CICC lobbied government and played a key part in informal discussions with the public sector. Whilst initially hesitant at the onset of the reform process the CICC later came to publicly supported the reform process. (CIN 20/11/1996: 1) The passage of certain key pieces of legislation and other non-legislative reforms to streamline the investment climate helped sway the CICC to supporting the reforms. In addition, public seminars were held on a weekly basis in 1997 by the team of international consultants attached to MFEM for the ERP. (CIN 23/3/1997: 3) Exploring issues such as business and capital development, the seminars were conducted to raise public involvement in the reform process, to raise public awareness of developmental issues and to help facilitate private sector development.

Facilitating Private Sector Development

During the second phase of the reform process a number of key reforms were initiated to facilitate the development of the private sector within the Cook Islands economy. One of the first to be enacted was the passage of the Development Investment Act in 1996²⁵. The Act itself led to the creation of the Development Investment Board (DIB), an organisation with the express aim of promoting and facilitating investment, both foreign and local, in an apolitical environment. Run by a secretariat working under the auspices of an independent board comprising leading members of the Cook Islands private sector, and one state appointee, the primary function of the DIB is thus to encourage and promote foreign and domestic investment. A number of incentives are now offered by the DIB to businesses wishing to invest in the Cook Islands. These include exemptions on customs duties and import levies for all equipment needed to establish or expand a capital venture and a complete 100% depreciation write-off in the first year of business operation. The DIB is also active in the development of new markets for the export of local products, as the expansion of non-traditional exports was seen as a necessary ingredient in creating sustainable

economic growth and development. (Cook Islands Government 1996: 12) Recent work has thus seen the DIB working with the Ministry of Agriculture in order to promote the development of a Pawpaw export market. (Ellis 1999) The DIB is designed to operate as a 'one-stop shop' to help foreign investors to manoeuvre through government regulations in a clear and transparent manner and thereby increase investor confidence. It has had some success in recent years, and there is a small but growing body of support in the local population behind its operation. (Wichman 1999) However, some problems are still to be dealt with and the lack of advancement on the production of a new Investment Code is one such cause for concern. Similarly, the continued existence of a list of activities reserved solely for indigenous businesses, including commercial ventures such as copra production, small retail shops, garment manufacturing for local sale and the commercial harvesting of pearl shell, shell fish and other reef and lagoon products goes against the principles of trade liberalisation espoused in the ERP matrix. Likewise, the continued reality of price controls on a limited range of essential commodities, principally foodstuffs, demonstrates that a number of ERP trade liberalisation objectives have been achieved. Another of the trade liberalisation goals of the ERP was the complete restructuring of the domestic banking and tax environment, but unlike the lack of movement on the topic of reserved activities and price controls, much progress has been made in this area.

A key objective of the reform process was the creation of a stable environment for private sector growth and development²⁶. One of the major tools to be used in achieving this broad objective were reforms of the local tax environment. The reforms were intended to reduce distortions of market signals and were designed so as not to drive up the cost structures of the export sector by keeping the costs of investment as low as possible and reducing the barriers for domestic and inwards foreign investment. These goals were achieved through the creation of lower marginal tax rates and a neutral tax treatment of all sectors. (MFEM n.d.) The tax regime was thus simplified from over three hundred tiers to only three, with the creation of a value added tax regime accompanying a three-band income tax structure

²⁵ However, while the Act was enacted in 1996 the DIB itself only came into operation in 1997 due to some initial start up problems.

with a 30 percent ceiling and zero deductions excluding a universal exemption of the first \$6 000 earned by all tax payers. Similarly, the top rates for personal and company income taxes were also reduced in an attempt to spur further domestic and foreign investment within the Cook Islands. Amendments were also made to the Income Tax and Turnover Tax Acts in 1997 in order to broaden the tax base, reduce the number of taxes, reduce average income tax rates, eliminate tax on taxes, allow the immediate deductibility of new capital expenditure and eliminate double tax on dividends.²⁷ These steps, combined with the introduction of a Value-Added Tax (VAT) of 12.5 per cent in July 1997, have thus acted to reorient the tax regime towards taxing consumption rather than income.²⁸ The recent introduction of these changes, however, means that their long-term effects on economic development within the Cook Islands is still to be felt. The movement of the tax regime away from an income base and towards a consumption base should, however, help in the long term delivery of revenue to government coffers, providing as it does a broader and more consistent tax base from which to collect revenue.

Whilst tax reform has done much to enable and facilitate increased private sector development within the Cook Islands, another of the original ERP objectives was the promotion of key sectors of the local economy. Three major areas of local industry that the Cook Islands government had hoped to stimulate through the reform process were the agriculture, marine aquaculture and tourism sectors. However, a number of constraints in the development of the three sectors had been identified in the ERP. A lack of flights is the main constraint for the Tourism industry, whereas Pearl farming, with its necessarily long time horizon, involves considerable capital risk. (T. Crocombe 1999) The key constraint for the development of the agricultural market is

²⁶ Access to capital for private sector investment was facilitated through the strengthening of the Cook Islands Development Bank (CIDB), which was merged with the Cook Islands Savings Bank.

²⁷ The current tax brackets are as follows:

First US\$4 182	Tax Free
US\$4 182 - US\$6 970	20%
US\$6 970 - US\$20 910	25%
US\$20 910 and over	30%

²⁸ The Value Added Tax Act 1997 provides for certain commodities and services to be either subject to VAT taxation at a rate of 0% or else be totally exempt from VAT payments. Included under these schedules are things such as resources to be used by the Rarotongan base of the University of the South Pacific and equipment to be used by outside donor agencies for aid guidance to the Cook Islands. The VAT thus covers almost all normal goods and services. The 0% rating means that while a supplier does not have to charge VAT on the supply they are still able to claim a deduction from all input tax relating to making the supply.

that prices of agricultural exports are prone to extreme variation – especially in the luxury tropical fruit market which is where the Cook Islands would be focusing. The problem with these constraints is that they are all primarily exogenous in origin. However, whilst long term policy and strategy statements were constructed for these three sectors in order to help resolve these exogenous constraints, additional endogenous barriers to the growth of these sectors still remain. One such barrier is the continued existence of certain tariff anomalies. Orange Juice was once produced on Rarotonga for export in the 1970s and tariffs were introduced to protect the domestic market. Orange Juice, however, has not been produced commercially anywhere in the Cook Islands for nearly twenty years yet the tariffs still exist and continue to provide a fiscal burden on domestic operations such as hotels and bars. (Ellis 1999) The archaic tariff system in existence today is therefore adversely affecting the growth of both the tourism and agricultural sectors providing as it does disincentives for investment. The establishment of a Tariff-Reduction Committee to analyse how to overcome existing anomalies has yet, however, to provide answers to removing such negative factors. The hurricane of 1997 also acted to set back progress in the marine aquaculture and agricultural sectors, although the freeing up of the formerly over-regulated private sector has helped in their development. However, progress is slow as some concerns have also recently arisen in the last year regarding the effect that economic development in certain sectors will have on the environment. One of the most well-known cases emerging from the ERP program was the proposal by the CIP-led government in early 1999 to establish a major black pearl farm in the Suwarrow lagoon. (Syme-Buchanan 1999: 38-39) Declared a national park by the Cook Islands government in the early 1980s, this decision was never given legislative force. Discussion of the possibilities of developing a Pearl Farming industry in the lagoon has thus met with resistance from both the islands population as well as environmental groups. Another concern of interest to environmentalists surrounds the issue of land tenure – an area where there is still a vital need for reform of the current system if the country's economic development is to be maximised.

Traditional communal land tenure systems have long been an impediment to economic development within the Cook Islands. High levels of population growth, coupled with high levels of immigration and low levels of return migration have led to the fragmentation of land titles. (Crocombe 1987) This severe fragmentation has

made attempts to acquire land rights and leases for aspiring businesses very difficult. Indeed, the importance of this issue meant that a land commission was set up in late 1995 by the government in order to investigate how the state could overcome such impediments to development while balancing traditional landowners concerns with commercial developmental needs. Reporting back in March 1996 the commission recommended amongst other things that: the maximum lease should be shortened from 60 to 30 years, that stricter requirements should be introduced on usage in order to retain land title, that land laws and decisions should be realigned with Maori custom and that steps be taken to reduce the extreme fragmentation of title that is occurring. However, emerging as it did, just as the full onslaught of the 1996 financial crisis hit, the government is still to act on its recommendations. One of the conditions of the ERP loan, however, was that new legislation on land tenure would be introduced that would seek to make traditionally owned land more accessible for economic development while still accommodating the legitimate concern of traditional land owners. In enacting this objective wide public consultation was undertaken through the use of Parliamentary Select Committee hearings. Computer hardware was then purchased with the goal being to create a comprehensive land ownership database so as to formalise land trust management arrangements. (Rasmussen 1999) While the hardware was purchased, no database has yet appeared. Thus, while a number of advances have been made in the facilitation of the private sector within the Cook Islands, some other areas, such as the clarification and reform of the current land tenure system, still require greater levels of commitment from the government. Moreover, while the government is, due to economic necessity, committed to the economic objectives of the ERP, it is less inclined to support reform within the political sphere.

The Question of Political Reform

In early 1997 the government of the Cook Islands funded a national retreat, comprising members of various societal groups to review the progress of the ERP. While a general consensus was reached that progress on the ERP, to that point in time, had been good, one particular issue was targeted for increased focus, that being the need for political reform to accompany the economic reform program, and the desire for political responsibility to be devolved to the communities inhabiting the outer islands. (MFEM 1997) Operating under a Westminster-style system of parliamentary

government, the Cook Islands' parliament consists of 25 members²⁹ and elections are held every five years. At the initiation of the reform program in 1996 the ruling party, the Cook Islands Party, had been in continuous power for seven years.³⁰ However, concerns had long been raised that 25 MPs was more than a country of less than twenty thousand needed, or could sustain. Thus, while there has been wide support for the need for the reform process there was always been a desire that the reform process should include the reform of Parliament and the political system in general. John Herrmann, director of the Rarotonga campus of the University of the South Pacific, has been one of the main proponents behind the call for political reform, with his argument that political reform in the Pacific should accompany the process of economic reform. (CIN 9/8/1997: 5)

Political reform was not, however, included in the original program matrix for the ERP. Concerns with governance and the democratic process, however, have brought the need for political streamlining to the attention of the Cook Islands public. (Mellor 1997: 22) In fact, the public sector attempted throughout 1997 to introduce a paper to Cabinet entitled 'Streamlining Government'. The paper suggested, amongst other things, a possible reduction in both the number of, and the emoluments available, for Ministers. The paper called for the reduction of the number of ministries to 10, the number of Ministers from 9 to 6 and the reduction of the total number of Members of Parliament from 24 to 17. In November 1997 in support of these ideals, the NDC began to publicly argue for the establishment of a 'Political Reform Commission' in order to canvass public opinion on the topic of political reform. (CIN 28/11/1997: 1) While not much progress was made at that point in time on the problem of wider political reform, much progress was, however, made on the topic of devolution.

Devolution

One of the conditions placed upon receiving the second loan tranche was the legal decentralisation of a large measure of political and economic power to Vaka and Island Councils. Revisions were thus enacted to the Local Government Act in 1996 to enable the devolution of greater power to local 'Vaka' councils, with the Vaka Act

²⁹ With one member representing Cook Islanders living in Australia and New Zealand.

³⁰ At 1996 the seats in parliament were distributed amongst the Cook Islands Party (CIP), with twenty, the Democratic Party (DP), with three, and the Democratic Alliance Party (DAP), with two.

itself being passed on 27 May 1997. The main purpose of the Act was to legally decentralise a large measure of political and economic power to Vaka and Island councils and, where appropriate, to village-level bodies. The Ministry of Outer Island Development (MOID) took on a role as coordinator and facilitator of the devolution process. Civil society (the third sector of voluntary and non-profit organisations) was seen as being a key factor in the devolution process, government policy envisaged that civil society would play an increasingly significant role in the provision of services at the local community level as power was devolved to the local councils. (MOID 1997: 8) Increased focus was thus to be placed on community development as a means to support individual and families, with the end objective being self-reliant communities. This devolution of decision-making responsibilities to the local level was seen as an effective method to ensure community participation and ownership of reform outcomes as well as eliminate the dependency mentality that had been built up in the Cook Islands amongst the general populace. (ADB 1997: 3) Traditional leaders actively supported this devolution process, claiming that devolution would allow Ariki (traditional leaders) to have more say in the decision-making process. (CIN 30/9/1998: 1) The vocal support of the Ariki for the devolution scheme once again highlighted the continued interaction of non-state groups in the reform process. Wider Cook Islands society thus played a vocal and vital role in supporting and helping to shape the entire reform process. This was particularly evident in the role that the NDC played as government watch-dog. As an example of this active role in the reform process, in late 1997 the NDC submitted a report to government recommending a reduction in the size of the projected 1998 national Budget. They insisted that increases should only be allowed in two of the thirty-four items on the Budget – fiscal audits and Outer Island development – and that more Cook Island government functions needed to be privatised in further efforts to remedy the imbalance between government revenue and expenditure. Privatisation was thus seen as another key aspect of the reform process.

Privatisation

A Cabinet sub-committee was formed in 1995 to identify agencies of the government that could be privatised. As a result of the report from this sub-committee, Cabinet set up a Privatisation Committee in 1996, in line with the objectives of the ERP, to oversee the privatisation of state assets. The assets to be privatised included all four

national hotels, the Cook Islands Liquor Supplies Ltd and a number of government trading departments including the Printing Office and the Survey Department. In order to further this privatisation program, the Cook Islands Investment Corporation (CIIC) was established in 1998 through the enactment of the Cook Islands Investment Corporation Act. Controlled by a board of directors drawn from the private sector the CIIC's role included administering and managing the property and shareholding interests of the Cook Island government as well as facilitating the sale of government assets. In attempt to live up to the spirit of the ERP, the CIIC Act 1998 provides that the CIIC, and therefore the government, will not be involved in trading activities where the private sector is willing and able to undertake those activities.³¹

Thus far, in the process of privatisation, the government liquor monopoly has been abolished and opened up to competition and the Rarotongan Resort Hotel, the Aitutaki Lagoon Resort Hotel, the Government Printing Office and the Cook Islands Broadcasting Corporation have all been fully privatised. In addition the Cook Islands electrical utility (Te Aponga Uira), the Rapae Hotel and the Vaima'anga Hotel are all in various phases of the privatisation process. Difficulties have arisen, however, with the privatisation of the Vaima'anga hotel. With construction of the hotel still only partially completed, unpaid land rentals has meant that landowner Pa Ariki claimed ownership of the partially constructed Vaima'anga Hotel and the land upon which it lies. Such problems led to the CIIC expressing doubts over the government's handling of the sale of national assets, requesting closer scrutiny be paid to the privatisation process. (CIN 26/5/1997: 1) Additional problems with the privatisation of these government assets have also highlighted generic difficulties inherent in the privatisation process in small countries, the most notable being that of the creation of natural monopolies. For example, in order to clear an existing debt on the Rarotongan Hotel to prepare for private sale the Cook Islands government sold off 20 percent of its holdings in Telecom (Cook Islands) Ltd to Telecom (New Zealand) Ltd, thereby increasing their holdings to 60 percent and reducing the Cook Islands government to the status of minority ownership. The sale of the country's sole telecommunications supplier has not, however, led to efficiency gains for the consumer. Prices are still well above international benchmarks. Part of the problem at least lies in the fact that

³¹ Under private sector control, however, the CIIC had been seen by some as being just as corrupt and

Telecom (NZ) received majority ownership without any regulatory framework being put in place first. A very real problem which the Cook Islands government needs to address in the very near future, therefore, is the construction of clear regulatory frameworks in order to minimise the risks to the population of the creation of privately controlled natural monopolies. Questions have also been raised concerning the transparency of the sale of one of the formerly Government owned hotels to a local businessman. A PERCA report issued on the sale concluded that the Government could not claim that the transaction was carried out in a fully transparent and contestable manner. (Parliament of the Cook Islands 1998c) The Hotel was sold for NZ\$3.25 million with the attached condition that the money does not have to be paid for 10 years. This sale occurred despite the fact that larger offers were made for the hotel title by interested foreign investors. The lack of transparency in the sale of the Rarotongan once again raised issues of political manipulation in the private sector and by extension, the problem of political reform. While the public sector had been thoroughly restructured, the accountability and transparency of political decisions remains dubious.

Political Reform on the Agenda Again

Support for the need for greater political reform at higher levels increased as the program of economic reform continued. As the harsh economic reality of the post-reform environment began to emerge in the wake of massive redundancies in the public service, the political superstructure remained untouched. (Crocombe and Crocombe 1998: 192-193) Politicians' allowances had remained intact throughout the reform process, except for the temporary 15 percent pay cut in early 1996. The growing unrest at the lack of movement of the political reform front meant that in the middle of 1998 the country's daily newspaper, the Cook Island News, ran a series of articles where various models of political reform were proposed by members of the public. Following these articles, wide public support for greater political reform became increasingly vocal, with traditional leaders adding their voices to the calls for such reform to be undertaken. (CIN 20/8/1998: 1) The growing unrest led to the establishment of a commission in August 1998, at the bequest of the Cook Islands

inefficient as any institution under the previous pre-ERP regime.

Parliament, to examine the effectiveness and appropriateness of the current political system. Delivering their report in November that year, the Commission offered a number of recommendations for political reform. The major reforms proposed included a reduction in both the length of term, and levels of remuneration available to Members of Parliament as well as a reduction in the total number of seats available in Parliament. (Commission of Political Review 1998) This report, however, came under vociferous attack in Parliament. (CIN 4/12/1998: 1) Parliament strongly rejected the report's findings and declared votes of no confidence in two of the report's authors. The public reason given for the refusal of the report by Parliament was that too little consultation had occurred. (CIN 24/12/1998: 1) As, however, the commission had held extensive and wide-ranging public consultation throughout the drafting of the report, self-interest appears to be the real reason for the lack of political support for the recommendations of the report. In highlighting the continued existence of almost autocratic political self-interest within the Cook Islands, the 1998/1999 budget was sent back to Parliament by the NDC for not complying with the governments official budget policy statement. With Crown Revenues for 1999 being budgeted at NZ\$39.1 million and Crown Expenditure being budgeted as NZ\$42.9 million the NDC claimed that the budget was fiscally irresponsible. (CIN 26/6/1998: 1) After debates within chambers by Parliament the budget was still passed anyway, with Parliament claiming that they would fix any anomalies through the passage of a supplementary budget – which they duly did in December 1998. The passing of this budget in spite of the opposition of the NDC meant, however, that by the end of 1998 public confidence in government dropped to a new low. (Porter 1999)

Conclusion

The implementation of the Cook Islands' ERP can, in general, be termed a success. The majority of the objectives set out in the initial ERP matrix have either been achieved or significant progress has been made on their implementation. The most dramatic changes wrought by the reform process were witnessed in changes in the Public Sector. From a high of 3 153 in March 1996 the number of people on the Cook Islands public payroll has dropped by May 1999 to 1 319, a total drop of 58 percent. Service delivery, however, appears not to have been compromised by the reduction in

Public Service numbers. Moreover, the various legislative Acts passed by Parliament in 1996 have reduced political interference in the bureaucracy. Clear program objectives and associated practices of strict budgeting application have institutionally cushioned HOMs from pressure for additional spending objectives by their Minister's. Similarly, private sector confidence is on the increase, with a recent national survey of business expectation demonstrating that a high level of optimism exists within the domestic business community. (National Policy Division 1998) However, certain concerns still exist. A recently released survey showed that optimism for continued growth is contingent upon the government continuing to honour its commitments to the reform process, and the ability of the government to maintain a stable economic and political environment in both the immediate future and in the longer-term. (MFEM 1999) Additionally, a number of events over recent years, including the passage of a 1998-1999 budget that was not in compliance with legislative requirements and that relied on unspecified asset sales to fund current expenditure, the lack of transparency and contestability in the sale of the Rarotongan Hotel and the failure of Parliament to seriously consider the implementation of reforms to the current political system have raised lingering reservations over the continuing commitment of the Cook Islands government to the ongoing nature of the reform process. The sustainability of the reforms implemented thus far is also questionable to some degree. The continued existence of a still fragile fiscal situation and the continued problem of access to markets – both domestic and international – are key problems that are still to be worked out. Similarly, the existence of a public service consisting of 22 Ministries and 1 319 public servants may still too great a number for a country with a population of less than twenty thousand. Several ministries with a total staff of 700-800 may appear to be a more appropriate target. (ADB 1999a: 44) The implementation of the new accrual based public accounting system also raises doubts about the capacity of the public service to effectively maintain these new systems. Thus, while the general prognosis for the reform process so far has been favourable, enough concerns exist to warrant caution over the chances for continuing reform success within the Cook Islands.

CHAPTER FOUR

STRUCTURAL ADJUSTMENT IN PAPUA NEW GUINEA

Background

Situated in the South West Pacific, Papua New Guinea is endowed with a rich natural resource base, which includes major gold and copper deposits, large oil and natural gas reserves, vast expanses of agricultural land, and extensive forests and maritime fisheries. Yet, despite this apparently abundant wealth Papua New Guinea struggles to achieve sustainable economic growth, and with a Gini coefficient of 0.46 it has one of the highest levels of income inequality in the region. Thus the quality of life for the majority of the country's population is no better, and in many cases worse, than for those living in an average low-income country, with access to public services such as health and education severely limited. Increasing the standard of living of the majority of Papua New Guinea's population largely depends upon the achievement of successful economic development. However, the peculiar physical and social characteristics of Papua New Guinea present many formidable barriers to the achievement of this goal.

The exploitation of Papua New Guinea's resources has been hampered by the rugged nature of the country's terrain, the extreme heterogeneity of the population and the high cost of developing modern infrastructure. Economic development has therefore been constrained by the difficulties of establishing transportation and communication between population centres which are separated by rugged terrain on the mainland and by large distances between the islands. Moreover, the domestic market is highly fragmented due to the isolation of most medium and small-sized communities in Papua New Guinea – adding significant costs to any commercial venture as well as inhibiting the development of private capital. (Fairbairn 1993a: 2) There is also a chronic shortage of skilled and semi-skilled workers. Of the 20 percent of the population who hold formal employment, the majority are unskilled. Development capital and other forms of human capital are thus in short supply, resulting in a heavy dependency upon external sources of skilled input and labour. (Fairbairn 1993a: 2)

The economy is still largely mixed subsistence based. Moreover, about 80 percent of the country's population of working age engages in subsistence agriculture or small-holder cash crop production and does not form part of the country's cash economy, or does so only sporadically.¹ The majority of Papua New Guinea's highly heterogeneous population of four million therefore still live in small villages.² Most of their time is devoted to subsistence and customary activities, although the desire for increasingly sophisticated material possessions, and the associated penetration of these areas by a cash economy, means that Papua New Guinea has been characterised recently by increased levels of rural-urban migration. (Connell and Lea 1993) These circumstances provide the foundation for a markedly dualistic economy in which a dynamic capital-intensive minerals sector dominates, while 85 percent of the population derive their livelihood from low-productivity labour-intensive agricultural work. Thus, while agriculture provides a subsistence livelihood for the majority of the population, the mining and petroleum sectors account for over 60% of the country's export earnings. It is this ongoing emphasis on one narrow economic sector which has caused many of Papua New Guinea's economic woes.

Background to the Crisis

The shock closure of the Panguna mine on Bougainville in 1989 caused a complete revaluation of the expected revenue base for the 1990 national budget, resulting in major budgetary reductions for the upcoming financial year.³ The loss of the revenue associated with the mine meant that an expected budget surplus was quickly transformed into a deficit. And although favourable conditions on the international mineral markets in the early 1990s quickly restored the government's revenue base and produced sufficient income to offset the loss of the mine, the fall in the ratio of gold derived revenue resulting from the closure of the Panguna mine meant that

¹ The 1990 population census showed that 39 per cent of the population over 10 was employed, at least partially, in the cash economy compared to 22 per cent in 1971. (UNDP/ILO: Table 1.7)

² There are over 700 distinct languages in the country.

government revenues became increasingly reliant on oil royalties. The rapid growth of the Papua New Guinea economy in the early 1990s was thus powered almost exclusively by a very narrow resource sector.

The 1993 national Budget focused on an expansionary fiscal policy and reliance on supply side measures (especially tax reform) in order to stimulate both non-mining private sector investment and trade liberalisation.⁴ New policies introduced during this period also included labour market reforms, increased expenditures on social service and increased support for the agricultural sector. Brought in due to the inability of the non-mining sector to expand and generate jobs for a rapidly expanding labour force (Fairbairn 1993a), the implementation of these policies was enabled by the revenues generated by the growth of the mining and petroleum sectors. The key principles of the 1993 Budget therefore included:

- 1) revitalisation of the private sector (mostly to be achieved through supply-side forms of assistance);
- 2) the reordering of government expenditure to favour agriculture, health, education and law and order;
- 3) an increase in the emphasis on sectoral diversification and broad-based growth (in order to reduce the heavy dependency on the mining sector); and
- 4) a shift in emphasis from direct to indirect forms of taxation. (Fairbairn 1993a: 16)

The reforms introduced by this Budget were to have laid the groundwork for an increasingly export orientated approach in domestic industrial policy. (Fairbairn 1993: 21). These reforms were also intended to improve the country's stock of human capital as they placed considerable emphasis on improving access to education. (Gannicot 1993) Thus, as 1993 saw real GDP grow by a staggering 16%, the resulting boom led to school fees being abolished, commodity prices supported and public service salaries increased. Personal and corporate taxes were also heavily

³ The situation on Bougainville, while leading to the loss of the one of the country's main sources of revenue, also made additional inroads into the country's annual expenditure with defence spending rising from K40 million in 1988 to K92 million in 1991.

reduced over this period and wages were deregulated in an attempt to ostensibly stimulate employment. The boom, however, barely made an impact on unemployment levels, and despite an initial program of budget reduction combined with favourable international markets the early 1990s were still characterised by growing budget deficits, with the country's fiscal deficit growing over the period from 1991 to 1993 to about 5 percent of GDP. This serious fiscal imbalance, coupled with a dramatic slump in international mineral and petroleum markets in late 1993 and early 1994 meant, that by March 1994, rather than facing an economic miracle the Papua New Guinean government was in the midst of a growing fiscal crisis.

The Crisis

The fiscal crisis which faced the Papua New Guinea government in 1994 emerged from both endogenous and exogenous factors. In early 1994 international oil prices fell significantly below figures projected by government planners the previous year – figures on which budget income estimates had been prepared for the 1993/94 financial year. Rather than seeking to finance their growing debt with an international loan the Papua New Guinea government chose to finance their deficit from the domestic banking sector. Without foreign currency backing the Papua New Guinea banking system inevitably drew down from the country's foreign reserves in order to finance the governments growing deficit. Recognising that change was needed, the government undertook urgent budget revisions in March 1994, releasing a revised mini-budget in an attempt to alleviate the country's fiscal burden. Expenditure reduction measures coupled with increased export taxes on forestry products and revised personal income tax regulations were also undertaken in an attempt to limit the growing budget deficit. Yet these measures proved insufficient and the underlying fiscal imbalances continued to grow throughout the first three quarters of 1994. (AusAID 1996) The country's fiscal deficit rose to over 10 percent of GDP (including grants and on commitment basis), foreign exchange reserves fell from 1.8 months of non-mining imports at the end of 1993 to only half a month by the end of September 1994 while domestic public debt increased to K1.4 billion (or more than

⁴ In line with Papua New Guineas accession in 1993 to full membership of APEC.

30 percent of GDP).⁵ Poor economic management during 1993-94 had, therefore, led the country into a severe macro-economic crisis characterised by a widening fiscal deficit, declining reserves and ever increasing pressure on the exchange rate.

In August 1994 a change of government saw former Finance Minister, Sir Julius Chan, take over the leadership of the country. The new government responded to the news of the growing liquidity crisis by devaluing the Kina by 12 percent in September. However, large outflows of foreign capital continued unabated and in October the Chan government abandoned the long-standing 'hard kina' policy and floated the currency. (PC 5/10/1994: 1) The adoption of the floating rate strengthened the effectiveness of the monetary policy, but major capital flight out of the country continued and the contractionary fiscal policy of the mini-budget began to disrupt the country's population with hospitals and schools having to be closed due to lack of funds. Thus one of the key problems resulting from the fiscal clampdown resulting from the crisis of 1994 was that public spending on both the country's social and physical infra-structure suffered a disproportionately hard decrease. (Chand 1996: 5) Throughout this attempt at stabilising the economy the opposition had given its full backing to the government, but the opposition went one step further in calling for the stabilisation effort to be accompanied by a sacrifices at the political level, including abolishing members' and Ministerial allowances and a 20 percent cut on members' and ministers' salaries. (PC 17/8/1994: 4; Kavanamur 1998) Before such drastic political measures could be forced upon the government, however, the Australian government allocated Papua New Guinea A\$111 million in loans in September 1994 to be used over the next year in response to the worsening macro-economic environment within Papua New Guinea.⁶ However, the continued deterioration of the country's fiscal position caused the Papua New Guinea government to once again approach the Australian government, the IMF and the World Bank for money to fund its budget shortfall. (Gupta 1995) This proposal met with public denunciation, with

⁵ In June 1994 the President of the Manufacturers Council of Papua New Guinea warned the government of the need to address, even in the face of the growing fiscal crisis, the issue of domestic production outside of the natural resource sector. Papua New Guinea Manufacturers felt there was a growing need in the face of declining employment trends in small to medium enterprises to develop Papua New Guinea's manufacturing and downstream processing industries with a program embracing both the private and public sectors. (PC 1/6/1994: 21)

⁶ Yet, despite this, by June 1995 all government funds for health, education and infrastructure projects had been spent.

the General Secretary of the Public Employees Association (PEA), Jack Kutal, arguing that the interests of the Bretton Woods institutions and Papua New Guinea were not necessarily the same. (PC 24/10/1994: 5) A strike by 18 000 teachers in March 1995, the first ever by public employees, also demonstrated the depth of public feeling against the economic hardship brought on by the government's mismanagement of the fiscal crisis. (Hayashida 1996: 155)

Resistance to loans from the World Bank and the IMF emerged from a number of sources within wider Papua New Guinea society, with the NGOs being particularly vocal against the imposition of any structural adjustment program. (Brunton 1999; Sepoe 1999) Nonetheless, in April 1995 agreement was reached between the Papua New Guinea government and the Bretton Woods institutions over the establishment of a standby facility, and the release of an SAP loan (provided the Papua New Guinea government complied with 27 key conditions of an accompanying program of structural adjustment).⁷ The agreement was followed by the immediate release of the first US\$25 million tranche of the SAP loan.⁸ And although the agreement between the government and the Bretton Woods institutions occasioned much rancour, the structural adjustment program did receive support from some of the country's most senior politicians. (Namaliu 1995)

The Reform Program

The structural adjustment program included objectives such as the liberalisation of trade and investment policies, the creation of sustainable development of the forestry sector, an improvement in government planning capacity and the better delivery of public services. The five major components of the Papua New Guinea government's Structural Adjustment Program (SAP) were thus:

- restore and maintain a stable economic environment by sharply lowering fiscal deficits and improving fiscal management

⁷ For a complete list of these 27 conditions see Appendix Two: Papua New Guinea SAP Objectives.

⁸ The World Banks SAP loan was to be provided in two tranches of US\$25 million each. Release of the second tranche required the completion of a number of the key objectives of the SAP including satisfactory preparation of the 1996 budget and an assessment of the impact of the new Organic Law on Provincial and Local Level Government (OLPLLG).

- implement a series of structural reforms to enhance Papua New Guinea's competitiveness (by liberalising trade and investment regimes and privatising key government assets) and restore business confidence – thus bringing about a recovery in private investment
- promote sustainable, environmentally-sound natural resource development through implementation of effective forestry conservation and revenue policies
- substantially improve public service delivery through restructuring of public expenditures, significantly increase public investment, and initiate new non-governmental mechanisms to complement the public funds across regions by recognising the differences in per capita incomes and increase transfers to poorer provinces
- support measures to improve project and program implementation including emergency relief programs. (Chand and Stewart 1997: 62; Proctor 1996: 109-110)

Problems were apparent, however, in the implementation of the SAP right from the beginning of the reform process. In presenting the 1995 budget the government failed to begin restructuring the country's agricultural sector, promising instead to review current arrangements with a view towards phasing out the expensive, and extensive commodity price support scheme. Additionally, in October 1995 the head of the National Forest Authority, Jean Kekedo, was sacked over allegations of not acting fast enough to approve legitimate logging projects and for failing to produce a new forestry plan. Anecdotal evidence, however, claims that Kekedo was sacked for refusing to endorse logging projects of interest to certain powerful national politicians. (Brunton 1999) The Papua New Guinea Government also refused to abolish its so-called 'Slush Fund' (the Electoral Development Program (EDP)) and programs of price support as advised by the IMF and the World Bank, with the government arguing that the EDP and price support schemes were necessary to the country's social well being as they allowed money to be introduced into rural areas. (PC 9/1/1995: 3) In reality though, the circumstances provided by a political and electoral system based on patronage ties meant that politicians were loathe to modify systems, such as the price support scheme, which provided many rural producers, who also happened to be voters, with their only definite source of income. For the same

reason, the call under the SAP to phase out the Electoral Development Fund, which provided each MP with K300 000 for 'developmental' projects within their own electorates, also met with widespread political opposition. Elections in Papua New Guinea are dependent upon local and not national level issues. Parliamentary seats are won by mobilising parochial interests and kinship ties rather than policy concerns or party loyalties. Politicians are thus more dependent upon the support of 'big men' and their 'wantoks' than they are on parties.⁹ The traditional role of distribution in Melanesian societies therefore means that 'traditional' Western conceptions of corruption do not quite fit with Papua New Guinea praxis.

In Papua New Guinea the link between politics and material gain, otherwise known as corruption, has been institutionalised by the Electoral Development Fund (EDF).¹⁰ Corruption is a major problem in Papua New Guinea, and is one of the main impediments to the country's economic development. The sorry state of the country's accounting of public finances is one of the key constraints in the battle against corruption. Over the years, the misuse of the country's accounting system, which appears to be a mixture of cash and accrual accounting systems, has contributed greatly to the country's problems of fiscal mismanagement.¹¹ The apparent arbitrary assigning of payments received to earlier periods by some departments (when they should be accounted for as part of the current period) is a practice which has contributed to the destabilisation of the Kina. This arbitrary accounting practice and others like it have enabled expenditure and revenue records to continue to be classified incorrectly, thereby reducing any transparency in the management of public finances. The Public Finances (Management) Act is the main piece of legislation governing the management of public finances in Papua New Guinea. While the passing of the Public Finances (Management) Act in 1995 in line with the goals of the SAP should have led to the creation of a more accountable and transparent public service, the lack of any subsequent enforcement of its guidelines, such as requiring

⁹ 'Wantokism (nepotism, favouritism) is prevalent in all walks of life, and goes hand-in-hand with the "Ah! samting b'long gavman" attitude.' (PC 3/11/1994: 10)

¹⁰ The EDF is allocated to each member of the national Parliament, and is operated by them for the direct provision of infrastructure and services in their electorate.

¹¹ In a cash accounting system the concept of matching rules directs that cash receipts and payments that occur within a period are reported in that period. In an accrual accounting system by contrast the concept of matching dictates that revenues earned (but not necessarily received) in a period are matched with expenses incurred (yet not necessarily paid) within the period.

annual accounts from departmental heads, means that its value as an agent for change for increased accountability within the public service has been lost. Thus although one of the main achievements of the Public Finances (Management) Act was the creation of the Public Accounts Committee in order to oversee the management of public funds, recent years have seen this committee fade away into obscurity. Related to the issue of corruption and public financial management, the issue of political reform is also a key strategem of the SAP process. This has been most conspicuous in the reform of the former Provincial Government system in 1995.

The New Organic Law (Political Reform)

At independence the task of nation-building had to begin from a frail base in terms of administrative capacity and human resources. In addition to the central government, provincial parliamentary governments were established and given responsibility for a number of public services, including education, health, and local infrastructure.¹² These provincial governments were supported by financial and staff resources from the centre, but a general lack of capacity combined with high levels of corruption meant that many did not function very efficiently. In June 1995, however, the enactment of the new Organic Law on Provincial and Local Level Government (OLPLLG) meant that this entire layer of government was removed. While the 19 provinces remained in place, the five hundred salaried provincial level politicians lost their positions with their powers devolved both downwards to local governments and upwards to the national assembly. National Parliament MPs became members of provincial assemblies and presidents of their electorates local-level assemblies. Additionally, regional MPs took on the responsibilities of Governor of their respective provinces, while assembly members of the 267 local-level governments would also sit in the provincial assemblies. The creation of this new bipartisan model gave national MPs considerably more power over the distribution of resources within their electorates. Thus, while the reforms were decentralist in intent, their end result may be the increased centralisation of power in Waigani. The linking of local and national

¹² The initial establishment of these provincial governments had more to do with placating the secessionist tendencies of the North Solomons Province, but despite this the Provincial Governments

level politics through the new membership requirements of the provincial assemblies may thus have done little for local-level development, and instead merely created a new opportunity for corruption and patronage-based politics. (May 1997) While the old pre-1995 provinces were bureaucratic, corrupt and provided little room for public participation they did, however, provide alternative sites of power and to some extent acted as a check on the excesses of the central government. (Ghai and Regan 1992) Indeed, some commentators have argued that successive national governments gave provincial governments little chance to improve, and that the politics of patronage and corruption that existed at the national level led to the disregard by national level politicians of the spirit of co-operation and consultation that underlay the original Organic Law. (Ghai 1997: 321) The new Organic Law could therefore be viewed as a vehicle that was created to ensure that funds remained with politicians at the national level, as the provincial governments were long seen by many national parliamentarians as possessing too much power and too much money. The singularly large vote in the national Parliament supporting the amendment underscored this belief (Hayashida 1996: 153) – a belief also voiced by Manus Governor, Stephen Pokawin, in his claim that the new Organic Law was nothing but an administrative extension of the national Government as powers once vested with the provinces have disappeared and are now vested in the national Government.¹³ (PC 13/2/1998)

The intent behind the amendment of the original Act had been to eradicate provincial mismanagement through the removal of administrative fragmentation and thereby remedy the chronic lack of accountability and coordination between provincial and central governments. (Larmour 1995b) Decentralisation was therefore supposed to increase government participation at the community level, improve service delivery levels and distribute funds more evenly, as the extensive system of provincial

did help spread the country's administrative load through the administration and provision of basic services and resources.

¹³ The establishment of the National Monitoring Authority (NMA) under section 110 of the Organic Law on Provincial Government and Local-Level Government does signal a commitment by the government of Papua New Guinea to increased accountability and transparency in the governance process at the local and provincial levels. Drawing its members from government agencies and wider civil society the NMAs major role is to monitor the implementation of government policies, especially as to how they pertain to sub-national levels of government in the new provincial government system. The NMAs mandate does not, however, extend to the monitoring of the use of state funds by elected officials, an oversight which effectively halves the ability of the NMA to render government spending fully accountable. Another key problem with which the NMA is faced is the lack of clear guidelines on

government had long placed a great strain upon the country's governance capacity. (May and Regan 1997; Standish 1983) The implementation of the provincial and local-level reforms have, however, faced serious infra-structural, financial and human resource constraints of their own. (Yala and Levantis 1998: 14) The distribution of funds to the provinces and local-level governments has been irregular at best, and the distribution of responsibilities between the various levels of government has been problematic due to a combination of ill-defined objectives and low levels of coordination. Thus far then, the implementation of the new organic law in 1995 appears to have done little to alleviate the problems of low capacity and chronic lack of infrastructure which have long bedevilled development at the local and district level in Papua New Guinea. (Gupta and Ivarature 1996) One of the key problems that has emerged in the system is the inability of many local governments to fill their public sector positions. The imposition of a fixed salary structure for civil servants across the country may have something to do with this predicament, as many of the more remote provinces, with limited amenities and opportunities for advancement, have a very hard time attracting staff. (Aloi 1999)

The new system also suffers from a lack of legislative and infrastructural support. Lack of legislative support for the reforms is characterised by the 14 'new' acts, referenced as 'to be enacted' in the new Organic Law, which are still outstanding. (Sause and Kinkin 1997) Similarly a legislative vacuum exists at the provincial and local levels as large numbers of laws are yet to be amended to be brought in line with the legislation. Inadequate infrastructure development has also meant that many district staff have remain confined at provincial headquarters. Yet, despite these problems, the transfer of former provincial level functions to lower levels of government has occurred at a startling rate.¹⁴ These very real problems of inadequate legislative, infrastructural and administrative capacity at the local government level is further compounded by the fact that funding levels in the form of provincial grants have actually dropped in recent years (see Figure 4.1), falling 22 percent in the 1998-1999 financial year alone. A situation made even worse by the fact that many

how it is to be funded and resourced, a problem which could directly impact on its ability to demand the improvement of performances by government agencies. (AusAID 1997)

¹⁴ In the 1999 budget alone, unfunded transfers included village courts, fire services, agricultural extension services and sections of police and regional prison administration.

provinces are receiving their funds late into the year, with the Eastern highlands Province not receiving its 1997 allocation until October of that year.

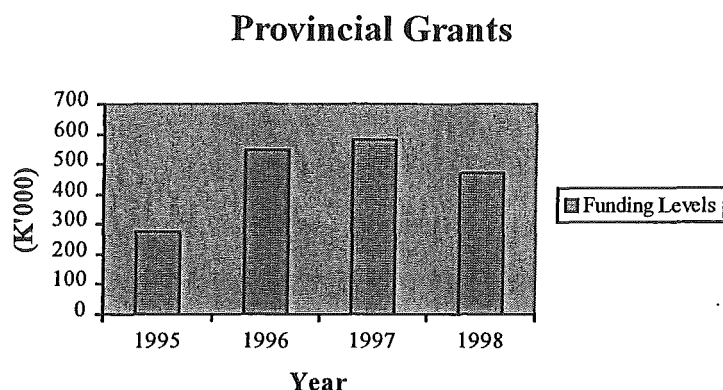


Figure 4.1 (Source: Papua New Guinea Department of Treasury 1999)

Other Developments in 1995

The second phase of the SAP was presented in late 1995 in the 1996 budget. Aimed at further stabilising the country's macroeconomic position it built and expanded upon the reforms initiated in the previous year, including the introduction of policies aimed at deregulating investment, removing price controls, and liberalising trade (especially the tariff regime). Other areas of the policy agenda which were to be deepened in 1996 included the review and rationalisation of the public sector, including the financial management systems currently in use, in order to improve the efficiency of the public sector and to create room for the private sector in the economic arena. Policies were also to be introduced in order to reverse the continuing decline in the delivery of basic economic and social services to the majority of the population. Under the adjustment program, fiscal and monetary policies in 1996 were geared toward maintaining an overall fiscal deficit of 1 percent of GDP in order to reduce the country's over-reliance on commercial borrowing. Maintaining fiscal discipline was thus seen as the key to improving the macroeconomic environment in Papua New Guinea.

Amidst vociferous political opposition, the Electoral Development fund was also finally abolished in the 1996 budget. It was replaced, however, by the Rural Action Program, a move supported by the World Bank as it promised more stringent levels of accountability on spending. The overall aim of the second phase of the reforms was thus based upon the need to review and rationalise the public sector in order to both improve its efficiency as well as open up possibilities for private sector growth, coupled with the need for the creation of sound policy frameworks in order to reverse the continuing country wide decline in basic social services. In doing so the reforms would continue along the path set by the earlier initiatives. This process did not, however, get off to a good start despite all this talk of fiscal rectitude, in January 1996 civil servants received a 10 percent pay rise, 6 percent higher than that announced in the budget.

Despite a mixed year of success in the implementation of the SAP, by the end of 1995 the country's macroeconomic environment was looking decidedly healthier. Thus, in spite of an overrun in recurrent expenditures, particularly on wages and salaries and interest payments, a small budget surplus was achieved in 1995 through a substantial cut in essential services and the public investment program. Economic activity was, however, estimated to have declined by about 5 percent in 1995 due to declining activity in the agricultural and industrial sectors and particularly in the mining, construction, and service industries. Similarly, non-mining GDP declined more than 3 percent in 1995 because of weather-related shortfalls in log and coffee production and lower than expected public investment outlays. Moreover, after showing initial signs of improvement, performance under the adjustment program suffered another setback in late 1995 and early 1996. While the fiscal accounts registered a marginal surplus in 1995, an improvement over a target deficit of 1 percent of GDP, the low level of expenditures on priority areas led to a further deterioration of service delivery levels.

Problems with the Loan

In early 1996 talks between the World Bank and the Papua New Guinea government over the delivery of the second instalment of the SAP loan broke down over Forestry and Logging Code amendments. The World Bank argued that it would not release the

second tranche of the SAP loan unless evidence was presented that there had been progress on the reforms outlined under the initial SAP agenda.¹⁵ (Hayashida 1997: 201) Matters appeared to be resolving themselves when the government agreed with World Bank representatives that amendments to the Forestry Act would be limited to technical matters only. Tensions reached boiling point in July, however, when parliament passed amendments to the Forestry Act altering the respective roles of the Minister for Forests and the Forestry Authority Board.¹⁶ The World Bank raised concerns over the way in which the power to appoint members of the Forestry commission was vested with the forestry Minister rather than the National Forestry Authority itself. (PC 30/7/1996: 1) Assertions by the World Bank that the entire SAP loan would be cancelled, unless the amendments to the Forestry Act were repealed and proposed new import duties and the planned reintroduction of certain price controls were cancelled, were met by defiant claims of non-compliance by the Papua New Guinea government who argued that the World Bank was directly interfering with their sovereignty. (PC 1/8/1996: 1) In the end this deadlock led the World Bank to force a 90-day ultimatum on the Papua New Guinea government to enact legislative amendments in order to meet the nine outstanding conditions of the SAP. Desperate meetings between the Papua New Guinea Finance Minister and World Bank staff in Washington DC were thus carried out throughout September in order to ease tensions between the two organisations and, as a result of these talks, on 8 October 1996 the Papua New Guinea parliament finally passed the Forestry (Amendment) Bill 1996 although four of the nine conditions still remained unfulfilled. In the end, however, the President of the World Bank recommended a waiver on the remaining four given that steps had been taken by the government towards resolving them. (Kavanmur 1998) With the major impediment to the delivery of the second tranche of the SAP loan having been removed the second payment of the loan was finally released in early 1997. However, some of the conditions that the release of the second tranche called for were extremely politically sensitive. One such sensitive condition, and one which provoked widespread protest, was the call for nationwide land reform.

¹⁵ The issue was not resolved until December of that year.

¹⁶ The amendments to the act acted to undermine the independence of the National Forestry Authority Board and enhanced the powers of the then Minister for Forests, Andrew Baing.

Land Reform

Land tenure issues in Papua New Guinea are a formidable barrier to investment. Existing government land policies remain contradictory and complex, and revisitation of land compensation many years after settlement has given rise to land disputes and undermined investor confidence in the security of land titles and leaseholds. Land disputes are endemic throughout Papua New Guinea due to both the communal nature of land tenure and the lack of established systems of land registration in most areas. The customary nature of the land tenure system means that investment is a very uncertain business with high levels of risk involved. (Crocombe 1968; Crocombe and Hide 1987) Such problems with land tenure have long been an impediment to private sector development. (Institute of National Affairs 1981) While official sources state that 97 percent of the total land area of Papua New Guinea remains in the hands of customary land owners, unofficial estimates place the amount of alienated land at closer to 1-2 percent. (Wolfers 1999, Barker 1999) One of the key objectives of the SAP had been the reform of the country's land registration practices, a process to be codified in the passage of the proposed Land Mobilisation Act. However, as has happened countless times before, the problems surrounding modification of land tenure issues in Papua New Guinea have often prompted instances of vocal protest or violent dispute. Thus, when university students set fire to five government vehicles in protest of the proposed legislation, and the law firm drafting the proposed Land Mobilisation Act had to cut short a fact-finding mission in Enga when protests became increasingly violent, an indefinite freeze was put on the legislative investigation by the government.¹⁷ (Wesley-Smith 1996: 431) The timing of the land reform legislation, however, may have greatly contributed to its failure to gain popular support as it followed immediately in the wake of the reforms on Provincial government – itself a piece of legislation widely perceived as being railroaded through Parliament against the majority of public opinion. (PC 16/6/1995: 2; Kavanamur 1998)

Despite certain difficulties such as those that arose from issues of land reform, a number of positive developments in the implementation of the SAP did emerge during 1996. Thus, under the auspices of the 1995 SAP, the Papua New Guinea government

introduced a new forestry tax regime designed to increase forestry derived revenues as well as enhancing the prospects for sustainable forestry activity. While certain aspects of these reforms were later amended at the insistence of the World Bank, the majority of the reform were retained. A substantial change was introduced on export taxes for round logs in order to improve rent capture, financial support to the sector was maintained through budget allocations to the National Forestry Authority and a sustainable cutting policy was introduced as was a logging code of practice with its associated improved enforcement of technical, environmental and conservation requirements. Policies were also implemented to prevent forest clearance on a large-scale and measures were undertaken to further strengthen and maintain the integrity and independence of the Forest Board. While these reforms helped provide clearer signals for the private sector, additional factors still constrain investment opportunities. One of the most difficult of these factors is the problem of law and order.

Law and Order

Peace and law and order are basic necessities for sound economic development, and there is little doubt that the fear of crime has become a significant impediment to the country's economic growth. In fact law and order, or its lack, has been claimed to be the single biggest obstacle to private sector development in Papua New Guinea. (Chand and Levantis 1998; Institute of National Affairs 1994) A recent report thus estimated that it resulted in K300-K400 million per year of lost revenue. (Institute of National Affairs 1999)

¹⁷ The Papua New Guinea government at the moment continues to register land under clan ownership in an attempt to avoid future land disputes, and to facilitate land sale if that is what the clan desires.

Government Spending on Law and Order

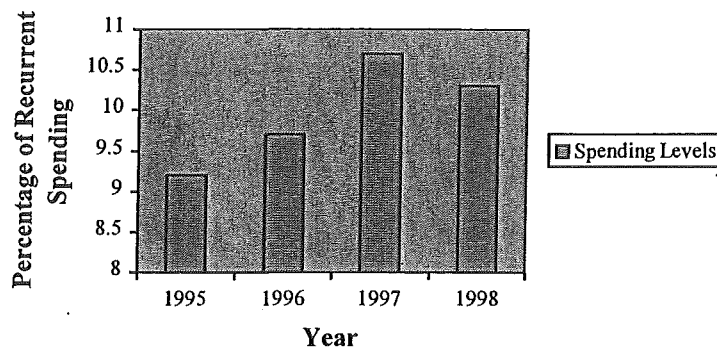


Figure 4.2 (Source: Budget Documents 1995-1998)

The law and order problem is to some extent linked to the migration of dissatisfied, unemployed youth to urban centres in search of jobs and money, although a long history of endemic violence and the relevance of a wide spread cultural tradition of 'payback' revenge violence can not be discounted. These dissatisfied youth often band together in large groups, and the majority of the country's criminal activity is carried out by these 'Raskol' gangs. These 'Raskols' often justify their actions through reference to corruption amongst those in power and their lack of accountability to the populace at large. (May 1998) In recognition of this escalating criminal problem, the Papua New Guinea government launched a major anti-crime initiative in 1996 and increased resources for police and security forces substantially (see Figure 4.2). However, despite this initiative crime rates have continued to rise and private sector representatives from the agricultural sector have warned that unless the law and order situation improves in the immediate future then it is possible that the entire tea and coffee producing sector could be wiped out. (Islands Business 1999: 16)

Other Developments in 1996

Also in 1996, in an attempt to further refine its planning capacity, the Papua New Guinea government released its Medium Term Development Strategy (MTDS) for the ensuing five year period.¹⁸ Designed as a rolling five-year strategy, the MTDS acts to

¹⁸ The country had developed an MTDS as early as 1985 but various events lead to it lapsing.

provide clearly defined long term priorities for government expenditure. The MTDS is focused on four priority areas: health, education, infrastructure and private sector development. In planning to develop those areas the MTDS is based on seven key components, these being:

- 1) Adhering to, and strengthening the policies begun under the 1995 Structural Adjustment Program;
- 2) Focusing program and budget expenditures on priority areas;¹⁹
- 3) Strict application of productive and priority criteria for projects to be funded;
- 4) Enhancing the resources available to Government;
- 5) Redefining the roles and functions of government;
- 6) Repositioning the private sector as the engine of economic growth; and
- 7) Carrying through the provincial reforms begun in 1996.

The MTDS thus provided discrete goals through which Papua New Guinea could achieve social and economic development.²⁰ Thus, all in all, while 1996 had not been as successful as the previous year, a number of advances were made in the country's restructuring efforts. However, this positive trend was not to last.

A Year of Troubles

The problems that had emerged throughout 1996 were further compounded in 1997. In March of that year military Commander-in-Chief Brigadier-General Jerry Singirok challenged the government over their hiring of mercenaries to put an end to the continuing troubles on Bougainville. During the next two week period the country was shaken by a period of considerable civil unrest with looting and rioting occurring

¹⁹ These priority areas are: health, education, infrastructure, private sector development, and governance and law and order.

²⁰ However, a key problem in this public planning and budgeting process in Papua New Guinea is that there only exists limited domestic capacity for the state to effectively implement and then monitor its policy plans and public investments.

in many parts of the country. In the wake of mounting pressure over the incident the then Prime Minister, Sir Julius Chan, and two of his leading Ministers stepped aside in late March pending an inquiry into the role in the affair. While the Prime Minister was later cleared of all charges, in the July national elections Sir Julius lost his seat, and Bill Skate was sworn in as the new Prime Minister. The Sandline affair revealed, amongst other things, the continued lack of accountability and high-levels of corruption that permeated the country's political system. One of the worst cases emerging out of the Sandline incident was the revelation that the Finance Minister had deliberately disregarded set procedures outlined in both the Public Finance Management Act and the Appropriation Act in order to obtain funds to help pay the mercenaries. (Kavanmur 1998) Anecdotal evidence also pointed to the fact that officials, fearful for their jobs, had provided advice on how the Minister could best manoeuvre around the various legislative and procedural blocking his way to accessing further public funds. (Wolfers 1999) Following in the wake of the Sandline affair, the 1997 general election saw 2 371 candidates stand for the 109 seats in the national Parliament. Only 51 or 48 percent of standing MPs were re-elected.²¹ The fact that 36 of the 109 elected were independents demonstrated the deep feeling of disenchantment felt by the electorate about the performance of political parties in general, and the performance of the past government in particular, in dealing with the country's macroeconomic and social woes. (Manning 1997: 3) Early 1997 also witnessed the destruction of much of the country's yearly copra and cocoa crops as parts of the island continent were severely damaged by tropical cyclones. The damage caused by the tropical storms was then compounded by the onslaught of one of the worst droughts in the country's history. Lasting from mid-1997 until early 1998 the drought crippled agricultural production, caused the closure of the Ok Tedi and Porgera mines and left more than 250 000 people in a state of near-starvation. In 1997 the main impact of the drought had been on smallholder and subsistence production as many commercial tree crops were still able to be harvested. In 1998 this situation was reversed with levels of coffee, copra and cocoa exports falling dramatically (see Figure 4.3). The biggest source of contraction in GDP in 1997 was, however, due to the mineral sector failing to maintain its previously high levels of production, due mainly to the closure of the Ok Tedi and Porgera mines during the

²¹ Only 40 percent of standing MPs retained their seats in the 1992 election.

drought. However, the drought may have been even more damaging to Papua New Guinea's long term economic prospects than these figures may suggest as it is generally considered that significant progress in terms of Papua New Guinea's economic development will depend upon on growth within the agricultural sector. (AusAID 1998: 7) The onslaught of the cyclone and drought severely disrupted the country's agricultural production, possibly setting back its development as a growth sector for many years. The drought may also have indirectly contributed to an increase in the importance of revenue derived from the mining and petroleum sectors, thus further deepening the reliance of the Papua New Guinea economy on these sectors.

Levels of Tree Crop Exports

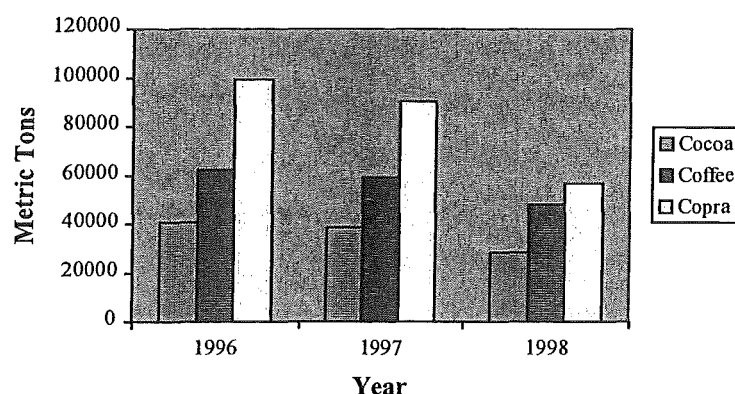


Figure 4.3. (Source: Government of Papua New Guinea 1999)

Despite all these difficulties, however, certain positive events helped mitigate the many political and economic failures of the year. January 1997 saw the establishment of the Papua New Guinea chapter of Transparency International, a move supported by a number of groups from both civil society and the private sector, including the National Council of Women and the Business Council of Papua New Guinea. (PC 23/7/1997: 7) Transparency International had three key objectives in starting a Papua New Guinea chapter, those being: the promotion of honesty and transparency in public and private dealings involving government and business; the raising of awareness of the presence and adverse effects of corrupt practices; and the development and implementation of an effective anti-corruption program aimed at

key players in government and business. Despite its public statement of an anti-corruption intent, the integrity of the new Transparency International chapter was questioned by some senior public servants who claimed that it had strong political connections, and so was necessarily complicit in the wide web of corruption which encircled Papua New Guinea political life. (PC 25/6/1997: 6)

1997 was therefore characterised by a lack of progress in the reform process. Groups within civil society, however, maintained their commitment to the reform process and their desire to reform their country's underlying governance structures, with groups such as the Business Council of Papua New Guinea calling for the abolishment of the Rural Development Fund, arguing that the funds would be better spent if redirected through the new provincial system. (PC 1/9/1997: 2) And, in one of their last actions of the year, the incoming government instituted a one-year freeze on employment and wage increases for public servants from 19 November 1997, in an desperate attempt to limit the potential for a fiscal blow-out. However, the continuing existence of high levels of corruption and the unforeseeable destruction of much of the country's agricultural production seemed to lead, in many respects, to a step backwards for the country's macroeconomic environment.

A New Year and a New Beginning?

The severe strain placed on the country's economic and socio-political infrastructure in 1997 led the World Bank to support a request by the incoming government to delay the presentation of the national Budget until March 1998 in order to allow the incoming government to formulate priorities on expected reviews of civil service and public spending.²² (PC 4/11/1997: 2) The emergence of such severe strain had also led to an outburst of vocal criticism against the interventionist policies of the Skate administration. Business Council of Papua New Guinea President, Mel Togolo, said that the private sector had been worried about the number of recent Government decisions, and that development initiatives based on annual budget assumptions were not really promoting development in the country. (PC 21/1/1998: 4) In an attempt to

²² When it finally emerged, the 1998 budget was based on revenues of K2 411 million and expenditures totalling K2 500 million. The deficit of approximately 1 percent of GDP was to be funded by external borrowing.

dispel such criticisms the Government hosted a two-day national economic summit in February 1998 aimed at pooling ideas from public and private sector organisations and Non-Government Organisations to form long-term policies to restore development. In the wake of the summit a Consultative Implementation and Monitoring Council (CIMC) was created in order to make sure that the recommendations which had been made at the summit were actually presented to government. The CIMC, which is funded by AusAID through the INA, is composed of representatives from the government, the private sector, NGOs, churches and wider civil society.²³ Unfortunately, in spite of a continued commitment by such groups within civil society to the reform process, the same could not be said of the Skate government.

In the wake of the scandal surrounding the Sandline incident, which implicated the Finance Minister in numerous cases of manipulation of the law, the Skate government's breaches of statutory law requirements with regards to central bank financing also raised serious questions as to the true commitment of Papua New Guinea's governments to the rule of law. Although the Central Bank Act places restrictions on Central Bank finance to the government there were serious breaches of this restriction by various governments following its implementation. Such political manipulation led, in 1998, to the Central Bank exceeding its statutory limit on government debt and government advances, an occurrence supposedly impossible under the aegis of the Central Banking Act and its various amendments. However, despite the intent of the act, overriding control of monetary policy is still held by Cabinet. In a similar case, while the Industrial Development (Incentives to Pioneer Industries) Act was repealed by the Skate government in 1998 the government nonetheless granted pioneer status to three separate companies within weeks of the passage of the new legislation.²⁴ Claiming that the granting of the pioneer status to the companies was legitimate as the new legislation would not come into effect until the beginning of 1999 the government nevertheless failed to observe the 60-day

²³ The INA is a privately funded think tank with strong connections to the private sector. The CIMC has very high level membership with Sir Mekere Morauta a former chairman and Sir Rabbie Namaliu a former deputy Chairman, although the CIMC is primarily a private sector lobby group.

²⁴ The Industrial Development (Incentives to Pioneer Industries) Act was repealed in order to stop the *ad hoc* extension of income tax incentives by Ministers to new companies.

public posting period required under the Act. The government, while not breaking the law as such, had still violated the spirit of the law. Likewise, the massive decline in 1998 in both international forestry prices and international demand for forestry products following the Asian Financial Crisis led to massive pressures being brought to bear upon the Papua New Guinea government by private sector interests within the forestry sector to rescind the changes of 1996. Responding to these pressures the Papua New Guinea government reverted to the previous forestry tax regime. Reversion to the older tax regime resulted in an almost immediate increase in log export levels yet government revenue from this increase in log sales was negligible. All gains from the new tax regime had been lost due to the Papua New Guinea government bowing to pressure from private sector interests within the forestry sector to revert to the older tax regime whereas a moderate form of tax relief may have been a better decision. (Levantis and Livernois 1998: 67) These government moves were, however, met by protest from a number of NGOs, especially Greenpeace, who argued that the reduction in log export taxes did nothing for the country or the environment, and acted only to improve the profits of log exporters and their political cronies. (Vulum 1999a) These events were not aberrations, however, as under the Skate administration many issues of public policy became increasingly orientated towards vested political interests. A large number of civil service and agency heads were replaced under the Skate government and a fair number of departments were downgraded, converted to statutory authorities or amalgamated, all signals of increased political intervention in the bureaucracy. (Yala and Levantis 1998: 13) Indeed, over the period from July 1997 to the end of 1999 the Papua New Guinea government dismissed 3 Central Bank Governors, 15 Departmental Heads and 38 Heads of Statutory and constitutional agencies. Moreover, the negative impacts of such heavy-handed political intervention were compounded by a lack of progress in another SAP objective – that of trade liberalisation.

Trade Liberalisation and Private Sector Development

Through its membership of APEC the Papua New Guinea state has committed itself to a process that aims to eliminate all barriers to trade by 2020. Additionally, under the SAP, barriers to trade such as price controls were also to be removed. At the inception of the SAP price controls were in effect for a number of consumer goods, mainly food products. The 1995 SAP stated that most of these forty or so items then

under price control were to be deregulated by the end of 1995. By July 1999, however, only about one third of the items, mainly domestically produced food items, had had their price control removed. While there have been statements from various governments re-stating their intention to remove the remaining price controls, only a few of the remaining items, such as rice, flour and milk powder, have actually been rescheduled for price deregulation. (Manning 1999) The majority of items, including telecommunications, shipping and petroleum stevedoring, remain under price control and it appears that they will remain so in the near future.

Trade liberalisation was also one of the key objectives of the 1995 SAP, yet despite Papua New Guinea's membership of organisations such as APEC tariff levels in Papua New Guinea have continued to creep up. In November 1994 the government raised the middle band of Papua New Guinea's single column tariff schedule to 40 percent in an attempt to raise revenue. Import duties were also increased on special import items such as alcoholic beverages at the same time as government departments became liable for import duties at commercial rates. Additionally, in the March 1995 budget all existing trade bans were replaced with tariffs, initially set in most cases at 40 percent. (Wesley-Smith 1996: 430) The introduction of the 1.5 percent drought levy on imports announced in 1998 was just another example of this process.

As part of the reform of indirect taxes as specified under the 1995 SAP the Papua New Guinea government proposed to introduce a simpler set of tariffs on imports.²⁵ With help from the World Bank the government thus conducted a review of the tariff system then in place in late 1995. After the tabling of that report in November of that same year the then government announced that a major reform of both the tariff and indirect taxation systems would occur. This commitment to reform was reconfirmed in the 1996 budget. A green paper on tariff reform was subsequently released in 1997 and was followed by a further white paper in 1998. The Papua New Guinea government's White Paper on Tariff Reform made explicit the linkages between tariff reform and the commitment of the Papua New Guinea government to its continuing membership of APEC and the WTO. The tariff structures presented in these various papers then became the basis of the tariff reforms passed by Parliament in September

1998. The tariff reforms with their associated reduction in tariffs levels will be gradually introduced over an eight year period.²⁶ Thus, while there has been improvement on the trade liberalisation front, the extended time period over which these changes are to come about effectively dilutes the original intent behind their dismantling.

The Papua New Guinea government has, however, made a public commitment to trade liberalisation as exemplified through their continued membership of APEC. This public image was further reinforced by the establishment of a National Investment Policy in August 1998 in order to make the government's investment policy consistent with both the MTDS and the country's continuing commitment to APEC. (Peter 1999) The policy designed regulatory restrictions for investment and promotes greater transparency for the foreign investor. These goals were to be achieved through the strengthening of the IPA and the consolidation of its role as the co-ordinating agency for investment within Papua New Guinea.²⁷ Yet despite such apparently positive steps towards attaining true trade liberalisation, in reality the Papua New Guinea economy actually became increasingly regulated over the 1998-1999 period. The implementation of policies of liberalisation under the SAP were delayed under the Skate administration, including a two year delay in the implementation of the VAT and the extension of the tariff reform program from five years to eight. Moreover, the implementation of modified policies, such as the

²⁵ The introduction of a simpler tariff system is also consistent with its position as a member of APEC. The broad end objectives of the World Bank SAP are very similar in their nature to those of APEC.

²⁶ The tariffs are now set (as of 1 July 1999) at:

- Industry Inputs and Life Necessities	0%
- Intermediate Inputs	30% (will drop to 15%)
- Finished Products	40% (will drop to 25%)
- Luxury Items (including some agricultural products)	50%+

There will be a 5% drop in the tariffs applied to items every two years until they reach their final levels.

²⁷ The IPA is one of three government agencies which act to coordinate private sector investment within Papua New Guinea. Set up in 1992, in an attempt to facilitate increased levels of foreign investment, the Papua New Guinea government replaced the poorly performing National Investment and Development Authority (NIDA) with the Investment Promotion Authority (IPA) through an act of Parliament. The main functions of the IPA were to facilitate all non-mining investment by certifying all eligible foreign investments and establishing clear regulations for the registration process thereby streamlining the process of foreign investment. Also established in 1992 was the Small Business Development Corporation (SBDC) with its primary role being the promotion of the establishment and development of small businesses throughout the breadth of the country. In a similar vein the Industrial Centres Development Corporation (ICDC) was set up by the Papua New Guinea government in 1993 to manage and operate industrial centres around the country.

introduction of a needs based tariff in 1998, may actually have done more harm than good in diluting or even negating the positive effects of earlier structural reforms in many cases. Additionally, though some positive advances were made in 1998 through new developments such as the enactment of a new Fisheries Management Act (which established an up to date legal framework for the management of the countries fishing resources achieving full utilisation of its fishing resources which could earn the country up to K1 billion per year. (Vulum 1999: 35)), much of the government's policy making was questionable. Indeed, in open criticism of such lack of policy direction, private sector representatives began to speak of their lack of confidence in the Government in late 1998. Expressing concern and frustration about the general state of the economy, private sector leaders argued that present economic conditions were not conducive to business growth. (PC 29/8/1998: 3) Dissatisfaction with the direction of government policy was also expressed by other groups within wider society, with one of the most vocal being the Trade Unions.

Budget Troubles

When the 1999 Budget was finally tabled the Budget deficit for 1998 was found to have grown to K187 million, close to 2.6 percent of GDP and well past the expected deficit of 1 percent of GDP. The reasons behind this Budget blow-out can be traced to a number of questionable budgeting practices conducted by the government throughout the previous year including the unbudgeted expenditure of substantial amounts through the transfer discretion of the Minister of the Treasury and the accompanying accumulation of a large number of arrears over the year. Forecasting an overall Budget deficit of K80 million the new Budget was, like its immediate predecessor, overly optimistic in its outlook. With its stated objective being the substantial redirection of government spending towards certain priority areas, this objective was to be achieved through across the board recurrent spending reductions and the utilisation of substantial offshore financing. This overly optimistic forecasting of government revenues including the 12 percent drop in recurrent expenditure forecast in the 1999 Budget was to be achieved through the retrenchment of 6 500-7 000 employees. However, by August 1999 only 1 181 civil servants had been retrenched while a further 2 693 had been declared redundant but were still awaiting their redundancy payments. This undesirable situation was made worse by the fact that, of those 3 874 civil servants, only 574 had actually been removed from

the public payroll. Moreover, the ironic nature of the situation is made apparent when one realises that in spite of this retrenchment program 3 000 new employees were actually added to the public service payroll in 1999, a situation highlighting the extreme problems of coordination and integration existing within the Papua New Guinea state in terms of personnel and business management. Additional problems with the 1999 Budget also arose from the fact that tax receipts were forecast to increase by 11 percent, yet recent evidence shows that tax receipts for 1999 are about K60 million less than budgeted. In a similar vein, in order to reduce government expenditure, provincial governments were assigned new functions and responsibilities but were not granted additional funds to perform these new functions. In late February 1999 the government launched an initiative to privatise a number of state assets yet by July this had not progressed beyond the planning stage despite the fact that government expenditure in 1999 had been based upon the receipt of K65 million from privatisation sales. Thus, by the end of June 1999 the fiscal deficit stood at a massive K200 million, already K120 million over that forecast for the entire year.

The retrenchment plan of the 1999 Budget came under almost immediate attack from the Papua New Guinea Trade Union Council (PNGTUC). (Paska 1999) The PNGTUC was specifically opposed to the plans to scrap 15 government statutory bodies, agencies and committees. The wide ranging nature of these planned cuts led a number of other unions to join with the PNGTUC, with many of them declaring strikes in late 1998. Thus, what began as a Communication Workers Strike in October over payment of their superannuation fund ended with a day's stop work action by the Air Traffic Controllers' Association in November and further threats of nation-wide strikes. (Pacific Islands Monthly 1999: 32) Public dissatisfaction was made most evident when a number of women's groups, representatives of NGOs and many members of the general public joined forces with the trade unionists in a march on Parliament in November 1998. (Sepoe 1999) Whilst the unions agreed to return to work the following month, the underlying tension remained. This tension was further exacerbated when the government increased the level of MPs District Support Grants from K300 000 to K500 000 a year in December 1998. Indeed, the rising levels of public dissatisfaction eventually led to the adjournment of Parliament in December

1998 for seven months in order to prevent the casting of a no-confidence vote²⁸. The adjournment of Parliament did not, however, stem the high levels of civil unrest which continued to be expressed through various labour strikes and demonstrations as government spending on social services decreased.

A New Beginning

The first few months of 1999, like those at the end of 1998, were characterised by wide public dissatisfaction with government mismanagement and corruption, with the Catholic Archbishop of Port Moresby, backed by the Papua New Guinea Catholic Bishop's Council, publicly announcing his lack of support for the Skate government and calling for a change of government. (PC 1/4/1999: 1) Political machinations meant that by July 1999, the Bishop's call had been answered. With the Skate government ousted, Sir Mekere Morauta took over the reins as Prime Minister. The new government immediately set about trying to ameliorate the damage caused in the first six months of 1999, and to provide some stability to the country's ailing macroeconomic environment. In August, in an attempt to ease fiscal pressure, a supplementary Budget was passed in which the new government committed itself to a number of objectives including focusing government expenditure on fewer priorities, stabilising the currency, containing inflation, removing various barriers to investment in order to promote private sector growth and restoring the integrity of public institutions. The new Budget thus committed Morauta's government to a number of discrete objectives including increased fiscal discipline, the de-politicisation of the Public Sector, the stabilisation of the currency, and the construction of a macroeconomic framework conducive to private sector development.

Not all that occurred under the Skate administration in early 1999 was, however, necessarily detrimental to the reform process. Developments, such as the passing of the Privatisation Act in early 1999, were decidedly positive. This move expressed a renewed commitment by the Papua New Guinea government to the privatisation agenda though subsequent legislation may be needed to empower the Privatisation commission and to clarify its role. However, despite the fact that there is a long post-

²⁸ A 1991 constitutional amendment guarantees an 18-month period before a vote of no-confidence is permitted. In an attempt to avoid a no-confidence vote, as their 18-month grace period came to an end, the Skate administration orchestrated this adjournment of Parliament.

independence history of a push for privatisation by both domestic and international interests (Trebilcock 1982, 1983), public protest against the privatisation process is extremely vocal. Thus a strong and competent CEO will also be needed to steer the commission if it is to achieve its goals and not be consigned to the 'too-hard to implement' category. The 1 July 1999 also witnessed the enactment of the National Value Added Tax Act. The introduction of the new Value Added Tax (VAT) at a flat rate of 10 percent was accompanied by the phasing out of the old provincial sales tax system. Certain goods and services, however, were exempted from the new VAT tax – including education services, medical services and public road transport – in an effort to protect certain vulnerable groups such as the rural poor from the price rises associated with its imposition. The introduction of the VAT has so far led to a number of different positive outcomes, it has broadened the tax base, provided a stable and reliable form of revenue for the state, and it has begun a shift away from taxing of income towards the taxing of consumption.

Conclusion

In general terms then, the implementation of the 1995 SAP has been an abysmal failure. The swift containment of the fiscal deficit, the redirection by the government of expenditure on social and economic priorities and the partial liberalisation of the economy, most notably in terms of the removal of price controls and the rationalisation of the existing tariff structure were among the few successes. Similarly, some good progress was also made in the rationalisation and restructuring of policies concerning the forestry and fisheries sectors. However, after the initial stabilisation of the economy the Papua New Guinea government once again became lax in their commitment to staying within fiscal constraints, with many of the improvements that had initially been gained under the 1995 SAP later being lost under the Skate administration.

The SAP was originally implemented in order to restructure the country's governance structures in order to create a more resilient economic base. However, growth in the Papua New Guinea economy continues to be powered by the mineral and petroleum sectors, effectively masking weaknesses in other sectors such as agriculture. Likewise, Papua New Guinea's progress on trade liberalisation has been poor. For

example, it achieved none of its 14 commitments to trade liberalisation in 1997 that it set out in its 1996 APEC Individual Action Plan. This inaction meant that it was rated the worst performing APEC country in terms of furthering free trade in the region by 2020. In addition to the failure to address these issues of an economic nature, problems of administrative and political governance still abound. Frequent sackings of departmental heads have eroded the already tenuous independence of the country's bureaucracy, as have constant changes in the heads of statutory bodies and the questionable appointment of political cronies to various public bodies. Additionally, the 1995 SAP has done little to improve the living standards of Papua New Guinea's poor. The majority of the population are still generally illiterate and have low levels of access to safe drinking water, health facilities or public transportation and, by the end of 1999, Papua New Guinea was once again facing severe macroeconomic problems. Foreign exchange reserves had dropped to the level of only being able to provide one months worth of import cover, inflation was increasing and interest rates were running at over 20 percent. Large unbudgeted expenditures in 1999 had placed increasing fiscal pressure on the government and had led to the further devaluation of the Kina. In 1998 the budget deficit had risen to 1.8 percent, and would have reached 4 percent of GDP if new arrears had been included and the Central Bank had been paid market interest rates on the monies owed to it by the Papua New Guinea government. The 1999 budget under the Skate government had set a deficit of K80 million, but overly ambitious revenue assumptions combined with drastic underestimation of expenditure levels had resulted in a deficit of over K200 million in the first half of 1999 alone. Crises such as that which occurred in 1994 acted to expose the weaknesses inherent in Papua New Guinea's governance structure. The SAP was intended to address these weaknesses, but the resurgence of macroeconomic problems in 1999 signal that these same structural faults have not yet been overcome.

CHAPTER FIVE

COMPARISONS BETWEEN COUNTRIES

Initial Impressions

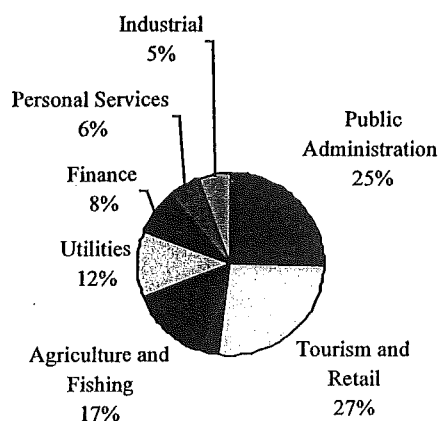
The Cook Islands has weathered a severe financial crisis and emerged from a painful period of reform with a more transparent and accountable system of governance. Papua New Guinea, on the other hand, is in many ways no better off now than before the initiation of the 1995 SAP program, and in some ways, if one considers the issue of bureaucratic morale and capacity, Papua New Guinea is now in an even more precarious position. How is it then that such similar programs of reform have led to such different outcomes? This chapter analyses the reasons behind these disparate reform outcomes in respect to the information presented in the two earlier chapters. While some of the justification for these events can be traced to issues such as sectoral dominance in Papua New Guinea and small absolute size in the Cook Islands, the majority of the responsibility for these disparate outcomes can be traced back to the broader issue of interaction - interaction between both state and society and between various societal groups. Whereas in the Cook Islands state and society worked cooperatively throughout the entire period of reform, in Papua New Guinea state and society were often at odds over the methods to be used in the reform process and, in fact, even over the very nature of the reform program itself.

Sectoral Diversification

One of the key issues in each country's program of reform, and in fact one of the key ideas behind the implementation of any program of structural adjustment, is the issue of sectoral diversification. Both reform plans contained explicit statements concerning the need to modify the sectoral characteristics of the country's economy through diversification and the promotion of certain 'new' sectors. However, if we compare breakdowns of the countries' GDP by Sector in both the pre- and post-reform periods we find startlingly different outcomes. In the pre-reform Cook Islands (see Figure 5.1) public administration constituted a quarter of the country's GDP,

while agriculture and fishing contributed only 17 per cent. Yet by 1998 the contribution made by the public administration sector to GDP had dropped by over a fifth, and agriculture and fishing had grown to the point that it now contributed nearly a quarter of the country's GDP (see Figure 5.1). A comparison between the two figures graphically demonstrates the radical sectoral transformation that the reform program wrought.

GDP by Sector (1993)



GDP by Sector (1998)

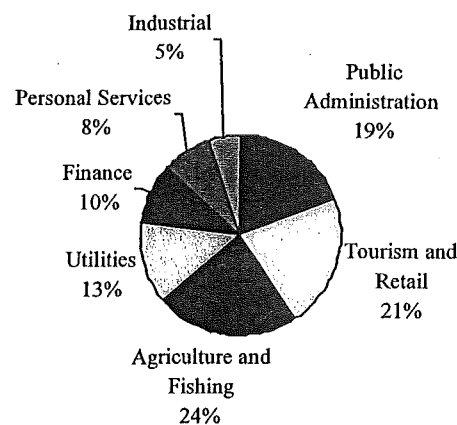


Figure 5.1 (Source: Cook Islands Government 1999)

The comparative analysis of the breakdown of Papua New Guinea's GDP by Sector in both the pre- and post-reform periods, however, presents an entirely different picture. Comparing the breakdowns of GDP by Sector in pre- and post-reform Papua New Guinea dramatically illustrates the failure of the SAP to bring about any real change

in the composition of the country's economy (see Figure 5.2). The minerals, mining and petroleum industries still contribute a quarter of Papua New Guinea's GDP, and while the agriculture and forestry industries have not shrunk as a proportion of the country's GDP, they also, however, have not experienced appreciable levels of growth.

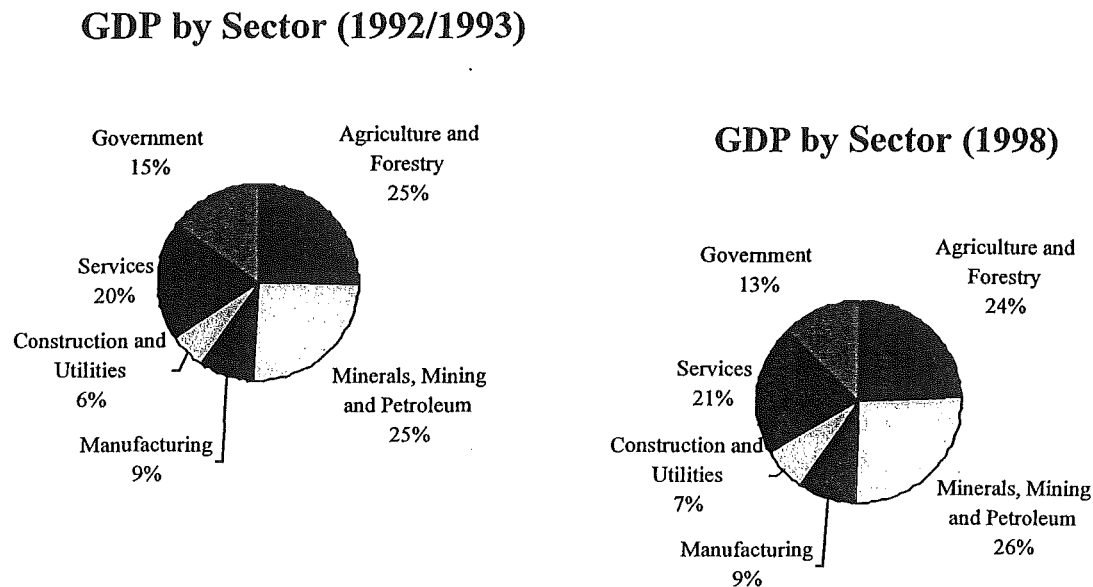


Figure 5.2 (Source: Department of Treasury and Planning 1999)

Part of the reason behind Papua New Guinea's lack of success in diversifying their economy may be attributed to a specific form of state-society interaction termed sectoral resistance.

Sectoral Resistance

The fact that certain groups, especially those with powerful positions of political or economic leverage, often acquire a stake in the continued existence of inefficient institutions is often a prime factor behind the failure of programs of reform to achieve the economic diversification that they set out to accomplish. For as a strong state is able to redistribute income and limit access to markets, economic elites may, in their own interest, prefer a weak state with an inefficient economy to a strong state with an efficient economy. (Bowles and Gintis 1996: 309) In a similar vein, a state's capacity

for economic restructuring can thus depend in large part on the nature of the country's leading economic sector. The autonomy and capacity of the state can thus be a function of prior sectoral development.

When large capital-intensive firms dominate the export sector, as in those countries where the mining and forestry industries dominate, states are likely to develop specialised expertise and taxing capacity relating to this sector such that the state has little capacity to restructure or diversify the economy.¹ (Shafer 1990, 1994:13) The state then becomes locked into a certain form of development trajectory. Papua New Guinea is a perfect example of this form of sectoral-led developmental trajectory. States are weakest when sectoral characteristics facilitate collective action by leading sector interest groups and limit the number and strength of alternative groups with which the state may ally itself. Conversely states are strongest when sectoral characteristics limit leading sector interest groups' capacity for collective action and generate alternative interest groups that the state can ally itself with. Sectoral traits thus determine opportunities for gain and the type of risk faced. Each sector generates characteristic patterns of lobbying and support which help determine the main paths open to the government in the re-allocation of resources and the reorientation of economic activity that the restructuring process involves. The sectorally determined domestic balance of power means, however, that the larger sectors are able to mobilise more support for their interests. Thus, when large capital-intensive firms dominate the export sector, as in mining for example, states are likely to develop specialised expertise and taxing capacity relating only to this sector, the end result being that the state has little capacity to promote restructuring or diversification of the economy. (Shafer 1994:13) Sectoral characteristics therefore crucially limit the capacity of the state to restructure the economy.² The problems encountered by the PNG state in attempting to restructure the country's forestry

¹ In fact sectors in which a small number of large firms monopolise the market (oligopoly) then these firms can act collectively to make sure that the state preferentially directs resources to them over other sectors. (Shafer 1994: 13)

² Shafer argues that sectoral characteristics are a determinant of not only firms' preferences but also of their capacity for collective action. The lower the economies of scale in a sector the simpler the technology and skill-level used; and the lower the capital required for entry into that sector, the lower the capacity of the sector for collective action. For reasons not unlike those put forward by Olson (1982) states, however, are not just passive receptacles of sectoral lobbying. Some states develop the capacity to counter these sectoral preferences. State capacities are to some extent, however, still largely the result of earlier stages of sectoral development.

industry are classic cases in point. Shafer (1990, 1994) thus argues that the key to reform success is the relative and absolute capacity of the state. States lacking such capacities will be unable to overcome opposition from business to the reform process. State capacity is thus, in some cases, itself partly a function of sectoral development. The political implications of each country's economic base are therefore an important determinant in considering the implementation of programs of reform. In Papua New Guinea the characteristics of the mineral extraction and forestry sectors continue to confront any government with powerful business opposition to the restructuring of the economy. The role of the mining industry, both public and private, in the conflict over Bougainville and the more recent Sandline incident are merely contemporary examples of the influence that mining industry wields in Papua New Guinea. The absence of any such large capitalintensive firms in the Cook Islands, and the very different economic base that it possesses compared to Papua New Guinea mean that the Cook Island state is more immune to capture by sectoral interests.

However, while the issue of sectoral resistance explains why Papua New Guinea failed to diversify its economy, it does not, however, explain why the Cook Islands were able to successfully diversify theirs. Instead, the success of the Cook Islands economic diversification program can be explained when analysed in terms of a more general form of state-society linkages - known generally as business-state linkages.

Business-State Linkages

Business-state relations are particularly important to the understanding of economic development in the developing world. Both Alice Amsden and Peter Evans thus argue for the existence of diversified business groupings as an aid to the development of embedded autonomy. For, rather than favour particular sectors at the expense of others encompassing, multi-sectoral business associations are more likely to press for policies that promote growth throughout the broader economy. (Olson 1982: 48-53) Thus in her analysis of the growth of the South Korean developmental state, Alice Amsden (1989: 146) argued that the higher the levels of reciprocity that characterised state-business relations the higher the apparent speed of economic growth. Similarly, the multi-sectoral nature of large conglomerates means that the diversified nature of their holdings means that, in general, they are not strongly opposed to changing

sectoral priorities. (Leff 1978: 672-673) Additionally, encompassing associations can assist collaboration between government and business by resolving inter-sectoral disputes within themselves.³ (Fields 1997; Thorp and Durand 1997) Collective actions by 'business' associations in a self-regulatory manner can also act to prevent the collapse of business-state relations into simple rent-seeking behaviour. However, in the absence of these large business conglomerations the same role can be played by horizontal organisations such as business roundtables. These business associations, in general, act as a channels for the exchange of information, thereby helping to activate the various processes necessary for the creation of embedded autonomy. Business associations can also maximise the benefits of government-business relations by limiting the pursuit of particularist benefits through collective self-governance. As these business associations can reinforce reciprocity even where states are incapable of sanctioning business, associations can thus be crucial to the functioning of networks of reciprocity and embedded autonomy. This supposition was validated in the Cook Islands. The active participation of the CIIC throughout the entire reform process meant that the country's private and public sectors were able to combine synergistically in achieving the country's ERP's objectives. In Papua New Guinea, as the country's private sector were split up into a number of different sectoral camps, no single over-arching business association existed. However, although continued protest by much of the Papua New Guinea private sector in the latter period of the Skate administration demonstrates that these various business groups can come together over certain issues, their competition at other times effectively limits their ability to provide a united front to constrain government mismanagement. Thus, while these camps occasionally came together to oppose or support particular pieces of government legislation in general the level of liaison between the various sectors of the country's private sector was not very high.

The importance of informal networks in this process should not, however, be overlooked, as Phillipe Schmitter's (1971) study of business associations in Brazil has demonstrated. There both the association members and Brazilian government officials regularly, in practice, ignored the associations. Similarly, in the Cook

³ For developed world examples of this form of self-regulating behaviour see example Peter Katzenstein, (1984) *Corporatism and Change: Austria, Switzerland and the Politics of Change* (Ithaca, NY: Cornell University Press).

Islands while the CIIC represented the public face of the country's private sector much of the real machinations behind the reform process occurred in informal meetings. (Epati 1999, Porter 1999) However, while these same informal networks operated in Papua New Guinea the lack of coherence at the macro-level meant that the positive effects of this form of interaction were dissipated. Thus while informal interactions definitely can act in a positive manner in the achievement of successful development outcomes, the absence of any institutional structure within which to operationalise these networks can lead to the loss of their effectiveness. Additionally, the small size of the Cook Islands played a positive role in the developmental process as it enabled a degree of trust to be fostered within both the private sector in particular, and between the various sections of Cook Islands society in general, which was necessarily lacking in the Papua New Guinea case. So while the existence of a tightly knit business community increased transparency in private sector-public sector interactions in the Cook Islands, the small absolute size of the country also played a role in its creation.

Similarly, the small size of the Cook Islands population also played an important part in the success of the country's reform program. The reduction of positions in the Cook Islands civil service led to a massive exodus of the country's population to New Zealand and Australia. This decrease in population numbers actually then aided in the achievement of many of the ERP's objectives. The reduction in the absolute number of people for whom social services had to be provided for considerably reduced the fiscal pressure placed upon the Cook Islands state to provide social services. The dramatic drop in the country's population also helps provide at least a partial explanation for the dramatic rise in GDP/Capita experienced by the Cook Islands in the latter part of the reform program. (see Figure 5.3) However, while in the short-term the dramatic population loss associated with the down-sizing of the civil service has had a positive impact on the success of the country's program of reform, the long term social and economic impact of the loss over 2 000 people in a country with a population of less than 20 000 is bound to be considerable. Thus, while some of the credit for this dramatic rise can be attributed to the country's success in implementing the ERP and it's associated program of structural adjustment some of the credit behind this phenomenon must be attributed to the ability of Cook Islanders to freely enter and exit New Zealand.

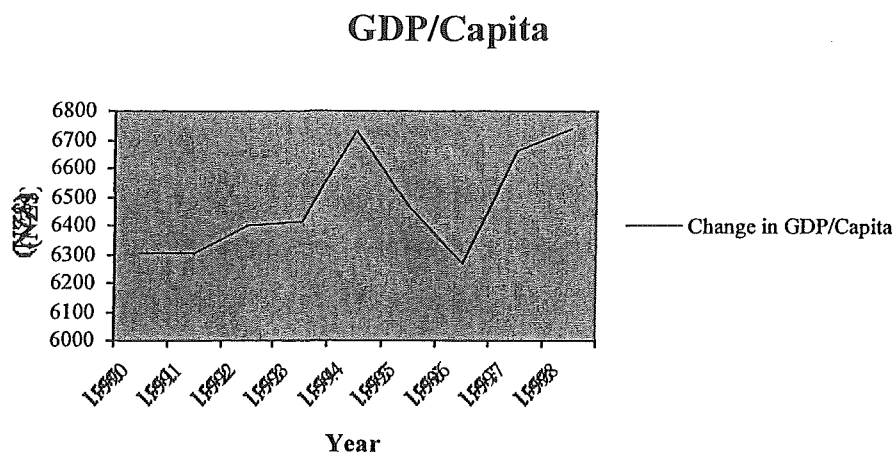


Figure 5.3 (Source: Cook Islands Government 1999)

In comparison, an analysis of the change in GDP/Capita in Papua New Guinea presents us with a very different picture. The data provides us with a graphical metaphor for the entire reform process in that country. GDP/Capita rises during the boom years of the early 1990s and, following the crisis of the mid-1990s, slowly declines. (see Figure 5.4) This is in stark contrast to the data presented for the Cook Islands case where, as shown above, following an initial decrease in the wake of the financial crisis that led to the implementation of the ERP GDP/Capita again rises steeply following the implementation of the ERP's most austere cost-cutting measures.

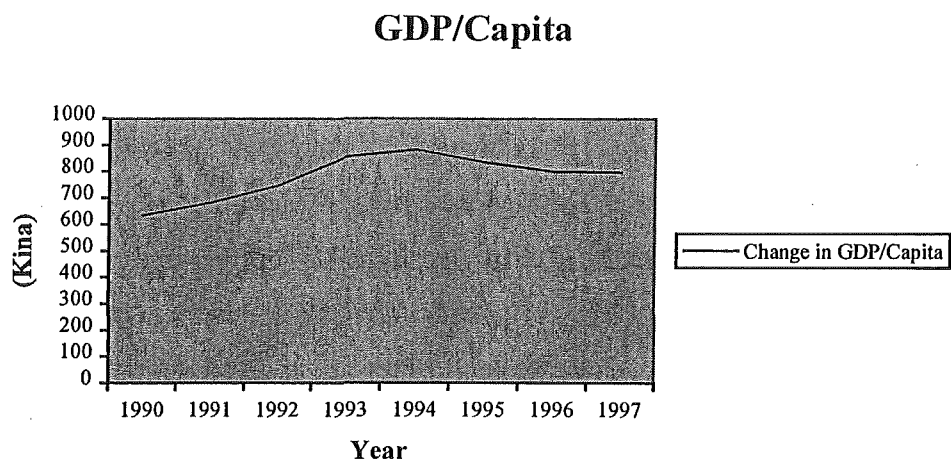


Figure 5.4 (Source: Department of Treasury and Planning 1999; IMF 2000)

Reducing Fiscal Expenditure

Another key factor in the success and failure of these countries' programs of reform was the reduction of fiscal spending. A comparative analysis of both country's revenue and expenditure over the period of the reforms once again presents startlingly different outcomes. In the Cook Islands revenue and expenditure were closely matched throughout the early 1990s as would be expected in a healthy stable economy (see Figure 5.4). Expenditure rose dramatically between the 1993/94 and 1994/95 financial years as a direct result of the government's attempts to offset the effects of the recession through keynesian means. However, with the successful implementation of the ERP, by the 1997/98 financial year government revenue and expenditure were once again closely matched, even with the absolute reduction in levels of government revenue factored in.

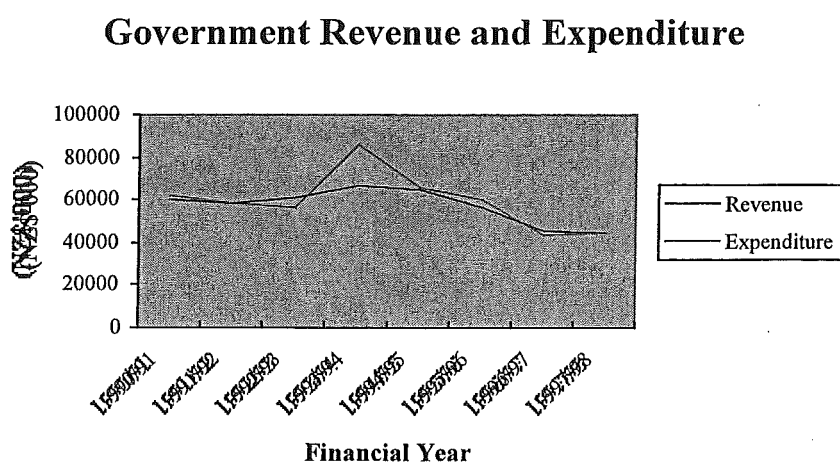


Figure 5.5 (Source: Cook Islands Government 1999)

A totally different story was played out in Papua New Guinea. Government expenditure, even in the boom period of the early 1990s, always ran at considerably higher levels than government revenue (see Figure 5.5). However, while the rapid stabilisation of the economy following the introduction of the SAP in 1995 reduced

the disparity between government inflows and outflows somewhat, the stalling of the SAP program under the leadership of the Skate government meant that by the end of 1998 the disparity between government revenue and expenditure had reached an all time high for the decade, in both absolute and relative terms.⁴

Government Revenue and Expenditure

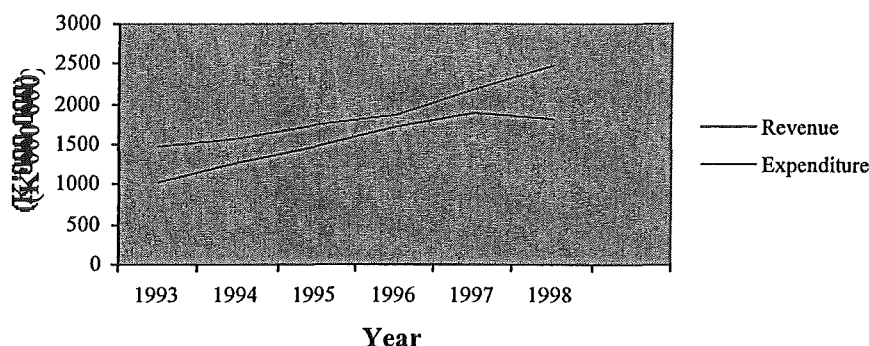


Figure 5.6 (Source: Department of Treasury and Planning 1999)

One of the key reasons behind the excessive levels of government expenditure experienced by both countries throughout this period was the high levels of recurrent costs resulting from the continued maintenance of a large and inefficient public service. However, while the Cook Islands was able to shed much of their excess civil

⁴ Two notable points arise out of any analysis of Papua New Guinea's recent macroeconomic history. While the economy has proved relatively easy to stabilise, even in the face of extreme shocks, the same can not be said of attempts to implement programs of structural adjustment. Five inter-related features of the PNG economy help explain why stabilisation is so readily achieved. Firstly, as an economy, it is heavily dependent upon imports. Secondly, the population of PNG has a high propensity to consume out of their disposable income. Thirdly, a high proportion of government expenditure is directed at consumption. Fourthly, the country's mining and petroleum sectors continue to operate regardless of the country's macroeconomic situation. Lastly, and most importantly, Papua New Guinea has always been able to rapidly mobilise financial support from the wider international donor community. (King 1997: 34-35) These various features mean that the manipulation of macroeconomic variables produce rapid results.

While these factors mean that that the PNG economy automatically stabilises relatively quickly they also mean that programs of structural adjustment are difficult to maintain. The failure of structural reform programs within Papua New Guinea can be attributed to the operation of four inter-related features. Firstly, stabilisation is achieved relatively easily. Secondly, the country is characterised by a highly decentralised system of governance. Thirdly, the country's bureaucratic capacity is extremely limited. The final factor is the absence of an effective domestic lobby group in favour of reforms. (King 1997: 34-35)

service during the reform process, Papua New Guinea, due to problems of both coordination and capacity, was unable to achieve similar results.

Public Sector Re-Structuring

Along with fiscal containment, the public sector is always a prime target of structural reform programs, especially with regards acts of retrenchment and wage restraint, all of which, however, do nothing to promote public sector capacity and morale. Additionally, as skilled bureaucrats in developing countries are in under- not over-supply, the implementation of stringent programs of cost-cutting and retrenchment can actually lead to the paradox wherein the more comprehensive and complex the program of reform intended, the greater the management capacity required to implement it, and as the case studies demonstrated, a weak and less than capable civil service was a key factor in the failure of the PNG structural reform program. The realisation therefore needs to be made that a shift to more complex forms of budgeting and accountancy systems needs to be tempered and adjusted to conform to local resource and capacity constraints. Recent ADB and World Bank reports have demonstrated the existence of this particular deficiency in the implementation of the reform programs in both the Cook Islands and Papua New Guinea. (ADB 1998) Thus, while it is important to learn from overseas examples, it is also vitally important to the success of programs of reform to consider a country's own particular indigenous environment.

Resolving Political Interference and Devolving Bureaucratic Control

In both the Cook Islands and Papua New Guinea low levels of morale, resulting from high levels political interference within the public service have led to low performance outcomes. This interference was particularly marked in Papua New Guinea with political influence extending throughout the entire public service. It is thus quite normal in Papua New Guinea for Ministers to directly influence the dispersion of funds by the Departments (Pentanu 1995: 9) and for Ministers to hire and fire their departmental heads as the mood takes them. In Papua New Guinea the instability resulting from this continued political interference had a particularly deleterious effect on the ability of the country to implement its SAP objectives. In the Cook Islands, however, while political interference in the bureaucracy still exists, the

existence of the MFEM Act made this interference much more visible. This increased transparency therefore meant that informal checks and balances, such as public discussion and shaming, were now able to operate as a means of regulating the performance of government. The reforms in the Cook Islands have thus meant that whereas previously there was responsibility without accountability the new transparency of government means that now responsibility is necessarily coupled with accountability. A positive spin-off of this increased transparency is that the Cook Islands public service is now more meritocratic in nature. However, the necessarily small size of the civil service means that 'bottle-necks' still exist within the public sector. These 'bottle-necks' reduce the chances for promotion and thereby reduce the incentives for public servants to work hard in their jobs. Similarly, the devolution of control of the various departments to their HOMs has also led to a reduction in previously high feelings of esprit-de-corps within the Cook Islands public service, the long term effects of which on Weberian norms within the civil service remain to be seen. For while the broadening of the discretionary powers of managers was the main reason behind the success of New Zealand's reform, the same process in the loosely controlled governance environment typical of most developing countries has in many cases only added to their already serious lack of accountability. The transferal of total financial control to bureaucrats could lead to bureaucrats building empires and undertaking rent-seeking activity, in precisely the same manner that corrupt politicians had once undertaken the same forms of activity. Anecdotal evidence concerning the devolution of power to local levels of government under the new Organic Law on Provincial and Local Level Government in Papua New Guinea already points to the emergence of this form of activity. (Aloi 1999) In a similar vein, the use of performance agreements between governments and senior civil servants in developing countries can also act to displace these same Weberian public service ethics of trust and responsibility that are already scarce on the ground in much of the developing world.

Reductions in public expenditures inevitably focus on the reduction of public service costs including salary costs. Problems arise, however, as a general goal of structural reform processes is the strengthening of policy management capacity. Reforms designed to improve this capacity have therefore generally included improved pay packages designed to attract and retain the 'best' professional civil servants. In

attempt to manage this problem the PNG government began using contractual arrangements for senior civil servants, but the process itself has been fraught with problems. The use of this contractual approach can unfortunately lead to the weakening of the already tenuous professionalism of the public service in the developing world. In Papua New Guinea many of the contracts between the state and senior public servants were negotiated outside of processes of the Public Service commission or the Department of Personnel Management and while they are all supposedly performance based this does not appear to be readily apparent. Remuneration of the contracts is extraordinarily high and stringent buyout clauses provide high levels of security to the appointees regardless of their performance standard. (Aloi 1999) Additionally, this movement towards high-level remuneration contracts for senior civil servants ran completely contrary to the Papua New Guinea Government's SAP inspired policy stance, since the floating of the Kina in 1994, of containment of public sector wages. Real wages of civil servants as a general group had thus fallen dramatically in the last six years at the same time as the placement of department and agency heads under contract has led to increases in the salary levels that these senior civil servants are receiving.⁵ Knowledge of the favourable salary rates that their departmental heads are receiving has thus led to the growth of a certain feeling of discontent amongst those lower level civil servants who see their pay steadily decreasing in real terms. (Aloi 1999; Hoot 1999) The high levels of remuneration available to high level civil servants thus acted to exacerbate already low feelings of morale within the general Papua New Guinea civil service brought about by the general policy of wage containment. This feeling of discontent has thus added to the general low feeling of morale currently present within the PNG public service.

Taking the Endogenous Social Context Seriously

The Public Sector reforms in Papua New Guinea and the Cook Islands were in large part based upon similar reforms carried out in New Zealand in the 1980s. These reform prescriptions were based on the premise that constraints and barriers to better

⁵ Some of the remuneration packages that these departmental and agency heads are receiving are as high as K500 000-K600 000, levels which are comparable, even with unfavourable exchange rates, to their counterparts in OECD countries. Knowledge of these extremely high salary rates has led to a certain feeling of discontent amongst lower level civil servants who see their pay steadily decreasing in

performance were primarily systemic and the removal of these systemic constraints would allow for greater accountability and transparency in the operation of the public sector. However, many of the New Zealand reforms worked in New Zealand because the institutional mechanisms to mediate and support them were already in place. The Cook Islands' close links with New Zealand in both the colonial and post-colonial periods has subsequently meant that, relatively speaking, their civil service's institutional structure was initially closer to the New Zealand model than Papua New Guinea's. However, this systemic explanation alone is inadequate to explain the abysmal failure of Papua New Guinea's reform program and the relative success of the Cook Islands' program. Thus, in analysing the Cook Islands' reform process, even the ADB concluded that:

models from developed countries are unlikely to be appropriate to island economies, so that their suitability needs to be investigated thoroughly, with special attention paid to domestic administrative capacity. (ADB 1999a: 49)

Continuing on the general theme of public sector reform, the general statement that public service capacity can be extended through strengthening of particular institutions so as to provide those institutions with the means whereby the resources available can be marshaled and sustained effectively to efficiently perform planning, policy formulation and implementation of tasks on any topic would appear none too contentious to the majority of those who create these programs of reform. However, the general statement that the Public Service in any country functions in a specific economic and political context would appear to be much more contentious, as this simple fact appears to have been lost on the majority of 'experts' sent to help Pacific Island countries achieve Public Service reform. This 'massive' oversight has led to the wasting of large amounts of time and money through experimentation with various administrative models which simply were doomed to fail in these Pacific countries' particular socio-political contexts. The simple realisation thus needs to be made that the context within which Pacific bureaucracies operate is very different from that in which the bureaucracies of the OECD operate. For while an independent bureaucracy is generally seen as a necessary prerequisite for successful reforms in the

real terms. This feeling of discontent has added to the general low feeling of morale present within the PNG public service.

'good governance' mode, Weberian bureaucratic norms of impersonality may be regarded as 'ethically suspect' in societies and cultures where people are expected to help their friends and kin. (Larmour 1996: 4) In a similar vein Farrugia (1993) has argued that the social environment in many small island states mean that their senior civil servants are often required to act in multi-functional roles. The small size of the bureaucracies in these countries thus leads, so Farrugia (1993: 221) argues, to "the formulation of a particular social ecology composed of a closely knit, integrated but open community with highly personalised relationships." The existence of these communities, with their associated personalisation of the policy process thus inexorably leads to problems in the implementation of policy and to the apparent lack of professionalism or attendance to Weberian norms of bureaucratic conduct typical of small developing country bureaucracies. Communities, however, also played a major role in the success of the reforms in the Cook Islands, and in moderating the social upheaval caused by the reform process in Papua New Guinea.

Moderating Mechanisms

Two key mechanisms mediated the social upheaval caused by the reform process in the Cook Islands, the cultural institution of extended families and the fact of New Zealand citizenship. The existence of migration to New Zealand as an exit option of last resort did much to mitigate any strong adverse reaction to the reform program. Additionally, however, the special relationship that the Cook Islands hold with New Zealand was also a key factor in the success of the reform program. Cook Islanders are all automatically dual citizens of New Zealand and the Cook Islands. The economic and social benefits of this link are enormous. The ability to move freely between countries provides a natural safety valve to economic shocks. Economic benefits also accrue due to the fact that the New Zealand dollar is the Cook Islands' local currency, monetary stability is thus ensured despite fiscal instability.⁶ Throughout the Cook Islands much of the pressure of the social and economic pressure of the reform process was taken up by another moderating mechanism –the country's extended families. During the program of reform when members of an extended family lost jobs other members of the extended family who were still in paid

⁶ A Monetary Board has been in existence since 1977. Among its responsibilities was the supervision of financial and banking services within the Cook Islands. Following the spirit of the reform process this responsibility was transferred to the Ministry of Finance and Economic Management.

employment helped care for those others of the family in positions of need. These social networks thus, through the operation of a form of the 'moral economy' popularised by the Political Scientist James C. Scott (1976), buffered the impact of the reform program through the operation of mechanisms of reciprocity and trust. A moral economy is one in which a subsistence ethos guarantees at least minimal levels of provisioning to all households. Concerned more with survival than with profit, individuals and groups within a 'moral economy' operate according to a 'safety-first principle', as for many of those throughout the developing world who live close to the subsistence level there is "little scope for the profit maximising calculus of neo-classical economics." (Scott 1976: 4) Knowing that help from neighbours is likely to be needed at any time, even very poor peasants are thus willing to share their meagre resources with others when needed - a type of behaviour reinforced through socially institutionalised combination of social sanctions and 'norms of reciprocity'. Thus, under a 'moral economy' even apparently irrational non-profit maximising patterns of action are maintained, reinforced as they are by diffuse social norms of reciprocity and sanction. The existence of a 'moral economy' in the Cook Islands was thus one of the major reasons behind the success of that country's program of reform. In Papua New Guinea a similar form of 'moral economy' also functioned across the country to moderate the adverse affects of the reform process. Here the 'wantok' system prevented those thrown out of work from needlessly going without. For while the Melanesian 'wantok' system can act to constrain the reform process, making as it does demands on politicians and public servants that conflict with their formal roles it can also, however, provide a useful social institution for those retrenched under a reform program. (ADB 1999a: 173) Cash incomes in poor households across Papua New Guinea are thus often supplemented by contributions by 'wantoks.' (McGavin 1993: 71)

Conclusion

There were thus a number of reasons behind the success of the Cook Islands program of reform and the failure of the program of reform undertaken in Papua New Guinea. From problems of sectoral resistance to the advantages of small size the reasons behind these differing developmental outcomes were many. A single thread, however, can be traced weaving throughout these various explanations. Binding them

together it brought a sense of coherency to these disparate social outcomes. This binding principle was the operation of multiple variants of state-society forms of interaction. In the case of the Cook Islands state and society worked together throughout the course of the reform program. While disagreements did exist over certain policies, the overriding theme behind the Cook Islands ERP was one of consensus and mutual agreement. In Papua New Guinea, however, state and society were in almost constant disagreement throughout the entire reform process over the both the policies to be undertaken in implementing the reform and the very need for reform program itself. The forms of state-society linkages necessary for the successful functioning of the developmental state state-in-society paradigm was thus absent throughout the entire implementation of the Papua New Guinea SAP. Without these linkages to act to create an enabling environment for the functioning of the mechanisms of embeddedness and complementarity that characterise the success of the developmental states – a form of linkage present within the Cook Islands but sadly lacking in Papua New Guinea – the developmental successes of the East Asian developmental states were unable to be duplicated.

CHAPTER SIX

THE PACIFIC DEVELOPMENTAL STATE?

Reflections on State and Society in the Pacific

As things now stand, the developmental state model thus appears most suited to countries with a relatively homogenous social makeup. The countries of Polynesia, and to a lesser extent, Micronesia, thus appear to all be prime candidates for its implementation. The heterogeneous character of Melanesia, however, would appear to preclude the usefulness of the current developmental state model as an instrument for developmental success in these countries. However, this is not to preclude its usefulness as a developmental model in Melanesia if it is suitably modified. As the previous chapters have shown, the realisation has now been made within the development community that, for better or worse, markets are always embedded within a social matrix where formal organisations and bureaucratic hierarchies are inextricably interlaced with informal networks and cultural understandings. There has thus been a recent resurgence of interest in the notion of civil society and its potential for improving both political and economic governance. (Cohen and Arato 1992; Hirst 1994; Putnam 1993) Studies in sub-Saharan Africa and the Pacific have shown that improvements in non-state capacity can improve state capacity if the reforms reduced reliance on state services or resources, or created community organisations capable of carrying out some state functions. (Bratton 1989; Taafaki and Oh 1995; Owusu 1997) Recent years have thus been witness to the re-emergence of civil society as an important variable in the analysis of state strength and capability. The emergence of this new developmental state paradigm has, therefore, offered up an entirely new area of research into the relationship between institutional design and economic performance. (Doner 1992; Haggard 1990; Hall 1986; Steinmo, Thelen and Longstreth 1992; Katzenstein 1985; Olson 1982; Zysman and Tyson 1983)

Drawing on the lessons of the Asian Miracle (World Bank 1993), the ideas of the Developmental Statists (and by extension the ideas behind the post-Washington consensus) are open to the importance of the development of human and social capital

in the development process. The paradigm of the developmental state has thus provided an original theoretical alternative to the previously dominant neo-liberal paradigm. Providing an innovative linkage between political institutions and economic performance, the new paradigm has brought politics back into the centre-stage of the development debate. Thus, where this thesis differed from other analyses of the role of the state in analysing programs of economic reform is in the way in which it posed the question: what constitutes a strong state? The key to this classification of state strength, the thesis argued, is the relationship of the state to wider society. State capacity is strongly dependent upon the relationship between state and society. Economic reforms, including those aimed at expanding the role of market forces, demand administrative and technical capabilities that are in short supply in developing countries. (Haggard and Kaufman 1992: 224-225) The limited capacity of these states means that they have to look elsewhere for help in expanding their capacity. Thus as the state becomes more deeply involved in economic transformation, non-bureaucratic modes of interrelation among the parts of the state apparatus become increasingly important. The success of programs of reform may thus depend as much upon the structures and strengths of civil society as they do upon the structures and strength of the state. The capacity of the state may therefore paradoxically depend upon the structural position that it occupies within the networks of information and trust spanning the political domain. (Broadbent and Ishio 1998: 81) State capacity is therefore dependent upon the degree of social connectedness of the state. The transformative capacity of the state is thus dependent upon a combination of internal coherence and external connectedness that can be called embedded autonomy. (Evans 1992: 176). Development is “not just a matter of ‘governance’, as the technicist illusion would have us believe: it is a matter of *politics*.” (Leftwich 1993: 624) The problem, however, is how to prevent social connectedness collapsing into nepotistic or predatory rent-seeking types of behaviour? Rephrased in a positive sense the question can instead be asked: How can we connect the state and wider societal interests in a mutually beneficial way? As we saw in the case studies, however, this is a harder question to answer than it may at first glance appear.

Comparing Case Studies

In general terms, the implementation of the Cook Islands ERP has been a success. With the majority of the objectives set out in the initial ERP matrix having been either achieved or progress made on their implementation, the Asian Development Bank concluded in their program completion report that the Cook Islands Economic Reform Program had been generally successful. (ADB 1998: 14) The structural reforms appear to have also worked at the fiscal level as recent years have been witness to budget surpluses with no aid money being needed to 'top up' the recurrent budget. The risk of another financial crisis occurring is still present but at an appreciably lower level of probability as the extreme budget imbalances that had led to the 1996 crisis is no longer in existence. Thus while the capacity for fiscal crisis still exists its likelihood is much lower. Additionally, a number of individuals have raised concerns that the government is still too involved in the private sector. These various individuals fear that the culture of reform has not penetrated very deeply and serious concerns were raised that the reform process could stall. There is thus a growing feeling amongst certain sections of the populace, especially within the Private Sector, that the momentum behind the reform process is dwindling. Another problem to be faced by the Cook Islands, even in the wake of a successful program of reform, is that of how to deal with the reality of a constantly shrinking population. With many of their best and brightest being lured away to the faster life and better money of life in Australia or New Zealand, one has to wonder as to the sustainability of current economic realities, as small domestic markets and remote locations present formidable obstacles to the development of a strong private sector in the Pacific Islands.¹ (ADB 1996: 28) While the loss of population associated with the civil service cuts of 1996 may have provided short-term relief to the country's fiscal problems the long-term consequences of this massive population loss may prove significant. Nevertheless, the structural reforms have provided a considerably more secure framework for the achievement of sustainable development through the creation of a considerably stronger private sector and politically insulated public sector. However, it was informal networks, between both state and society and

¹ In fact, Barrie Macdonald (1995: 23) has even cautioned that the geographical fragmentation and remote nature of Pacific Island economies from world markets might even mean that the preconditions

between different societal groups, that were the real driving force behind the reforms. These links between the state, the private sector and civil society were apparent throughout the entire reform process. Thus, while the reform process was driven by economic need, not by political will, a wide consensus existed throughout broader Cook Islands society of the need for the reform process. This combined with the public backing of the reform program by the PSA greatly reduced the political risk normally associated with similar reform programs, thereby allowing the Cook Islands government a mandate for reform not normally seen in the face of such far-reaching programs of reform. (Root 1996)

In contrast to the relative success of the Cook Islands reform program, however, the implementation of the 1995 SAP in Papua New Guinea can generally be regarded as a significant failure. The reforms were only really successful in terms of the initial goal of macroeconomic stabilisation. However, despite the swift containment of the fiscal deficit, the redirection by the government of expenditure on social and economic priorities and the partial liberalisation of the economy this early promise never carried through to the remainder of the reform program. Exogenous and endogenous shocks throughout the 1996-1999 period, including the 1997 drought and the Asian financial crisis, acted to once again expose the serious underlying structural problems facing the PNG economy. Thus, while the SAP was intended to address the various structural weaknesses that had led to the emergence of the fiscal crisis in 1994, the emergence of macroeconomic problems in 1999 signalled that these same structural faults continued to exist within the country's governance systems. Why was this the case? Commentators tend to agree that Papua New Guinea has tremendous opportunities for economic growth and development. However, these same commentators also tend to agree that economic development and growth will only be actualised in Papua New Guinea when the country's human and physical resources are utilised both more efficiently and more intensively. (Fairbairn 1993b) What mechanism or process was it then that is behind the success of the Cook Islands ERP and the failure of Papua New Guinea's SAP? This thesis has argued that this vital ingredient was the existence of state-society linkages. When successfully utilised this resource promotes the achievement of developmental objectives. This point was

for significant private sector development might simply not exist in the Pacific. This is an assertion,

made apparent in the case of Papua New Guinea where the social relationships necessary for the creation of the state-in-society forms of linkages popularised by the Developmental Statists never came into being. In contrast to this, in the Cook Islands these forms of linkages were able to be successfully mobilised in the achievement of the ERPs reform objectives. Why this is the case is the question that needs to be asked. The reason I would speculate is hidden in the very nature of these two countries socio-economic environments. The answer lies in the homogenous nature of the Cook Islands and the extreme heterogeneity of Papua New Guinea. The heterogeneity of Papua New Guinea, a heterogeneity present both within the country's cultural and economic make-up, may act to prevent the formation of wider horizontal linkages which may be a necessary pre-requisite to the creation of successful state-society forms of linkage. In order to provide a more thorough explanation of the relative reform success and failure of the Cooks Islands and Papua New Guinea respectively, we therefore need to look more closely at the notion of socio-cultural context and the associated concept of social capital.

Socio-Cultural Context

The notion that a country or region's socio-cultural context plays an important part in any developmental program has recently received a renewed lease of life. While the notion of a socio-cultural context has long played a vital part in developmental thinking it has all too often been phrased in terms of its negative impact on developmental outcomes. The early modernisation theorists thus saw traditional culture as an impediment to political and economic development, arguing that countries needed to adopt modern institutions and structures if they wanted to achieve economic development. Recent years, however, have been witness to the emergence of a more positive view of a country or regions socio-cultural context in respect to the achievement of developmental outcomes. Developmental state theorists have thus attributed much of the success behind the creation and maintenance of the East Asian developmental states, and the economic networks which underpinned them, to social sources, such as Confucianism, which, they argued, permeated the societies within which these states were embedded. (Hamilton 1998; Hamilton and Biggart 1988;

however, that will only be proved or disproved over time.

Woo-Cumings 1998) Theorists of the developmental state have thus argued that culture played a pivotal role in the organisational success of the East Asian developmental states. The rationale behind the emergence of this positive link between economic development and socio-cultural context can best be explained through reference to an emergent body of thought, particularly influential in the fields of economic and sociology, often known simply as neo-institutionalism.

Neo-Institutionalism

Neo-institutionalism, as a general theoretical model, maintains that institutions play an important role in mediating the social.² Neo-institutional economics thus asserts that market development, and hence economic development, is contingent upon the establishment of the correct institutional structures. These institutions then act to provide the correct regulatory framework necessary for the operation of the free market. Neo-institutional work in economics is therefore concerned with rule and governance systems that develop to regulate and manage economic exchanges. The founding of this branch of economics, which a number of the developmental state theorists draw upon, can be traced back to the pivotal work of Ronald Coase. In his nobel-prize winning work Coase (1937) questioned why some economic exchanges were carried out within firms under a governance structure involving rules and hierarchical enforcement mechanism rather than being directly subject to the price mechanism of the free market. The reason this occurred, Coase concluded, was that there was a cost associated in the use of the price mechanism, these costs being those of negotiating and concluding a separate contract for each exchange transaction that took place in the market. (Coase 1937: 389) Firms thus arise in order to provide a framework through which these 'transactions costs' were to be administered. Neo-classical models of the efficient market would only apply when it was cost-less to transact, therefore when, as is normally the case in real-world situations, transactions cost, institutions act to mediate the costs of these transactions. (North 1995: 18) Transaction costs thus arise because information is not perfect and is generally asymmetrically distributed amongst the parties participating in an exchange. Neo-institutional economics therefore focuses on the postulate that institutions, following

² In a brief note of definition, institutions, ranging from formal arrangements such as constitutional provisions, statutes and judicial rulings to informal arrangements such as conventions and customs,

the seminal work of Ronald Coase, are formed to reduce uncertainty in human exchange. (Coase 1937; Coase 1960)

In expanding upon this initial neo-institutional framework Oliver Williamson (1975, 1985) argued that these transaction costs were a function of two paired conditions. When these two-paired conditions were met during a transaction then that transaction, be it economic or social, would then be transferred to an organisational framework such that it reduced the uncertainty within the transaction. These two conditions were a) when a situation of bounded rationality occurred during a transaction at the same time as there was a high level of uncertainty and risk associated with the transaction; and b) when individual opportunism in the transaction was paired with an absence of alternative exchange partners. Thus under the emergent neo-institutional paradigm, the emergence and persistence of social institutions such as *wantok*-ism, and the organisational bodies that bear them, can be explained as a means by which transaction costs arising from social exchanges can be reduced.³ Additionally, by using an organisational structure or system of networks, which are in general relatively stable through time, these transaction costs are then able to be further reduced through the introduction of stability to the process of exchange, as this stability reduces the degree of uncertainty in the exchange process.⁴ The social networks in East Asia mentioned before acted in precisely this manner, providing both stable frameworks for economic exchange and a basis upon which relationships of trust could be built up between senior bureaucrats and private sector leaders.

These networks thus exist within the midst of all forms of human social structure including markets and hierarchies, and like institutions can exist both formally and informally. Networks, as such, can be defined as patterns of identifiable interactive relations which link social units. Networks and the relationships inherent within can,

critically affect decision making regarding resource use thereby directly affecting economic behaviour and performance.

³ This argument should not be seen to reduce all human action to the calculating calculus of rational choice so beloved of many a Political Scientist. Instead the concept of transaction costs is used in this thesis merely as a useful lens through which to explore and analyse a certain form of human behaviour.

⁴ It is necessary, however, to clearly distinguish the differences between institutions and organisations. Institutions are the humanly devised constraints, both formal and informal, that structure human interaction (they are the rules of the game) whereas organisations, on the other hand, are groups of individuals bound by a common purpose to achieve common objectives (they are the players of the game). (North 1995: 23)

however, paradoxically function both as structures of opportunity and as sources of constraint. As shown above, in the case of the East Asian Developmental States these networks acted as structures of opportunity, combining synergistically with various structures of the state in the achievement of positive developmental outcomes. Similarly, in the Cook Islands, already existing social institutions and networks helped to both alleviate the negative impacts of the reform process as well as encourage positive and successful interaction between various aspects of Cook Islands society in the achievement of the reforms objectives. This was not the case, however, in Papua New Guinea. In Papua New Guinea these same forms of networks acted to undermine the reform process. In order to begin to explain these divergent outcomes we need to draw upon one other emergent body of theory within the social sciences in general and in development studies in particular; that of social capital.

Social Capital

A reading of the work of the political scientist Robert Putnam provides an initial starting point to an analysis of the notion of social capital. In his ground-breaking work on provincial government in Italy, Putnam asked 'how is it that norms and networks of civic engagement undergird good government?' (1993: 116) In answering this question Putnam argued that the act of involvement of individuals in civil associations leads to the production of civic communities, the members of which then engage in collective action for mutual benefit, simultaneously demanding government responsiveness. Putnam's work can thus be seen as a renewed form of the de Tocquevillian conception of civic engagement through associational life. Putnam's general theory, succinctly stated, was thus that where strong horizontal linkages occurred, as opposed to strong forms of vertical relationships, social capital was produced which could profitably be used in order to undergird and support the construction of further social, political and economic relationships. In expanding upon this initial theorising, Putnam argued that social institutions constitute a form of this social capital, which he defined as "features of social organisation such as networks, norms and social trust that facilitate coordination and cooperation for mutual benefit." (1996: 292) Social capital can thus be defined as dense networks and norms of trust and generalised reciprocity which bind social groups together. Putnam further claimed that this resource of social capital enables civil society to act as an

empowering force for economic and political change and development. Putnam then went on to argue that the capacity of government to provide social services depends upon the stock of 'social capital' derived from participation in civic associations, as these associations provide public authorities with valuable information. These civic associations thus have a direct impact on the quality of public services as watchdogs and monitors of governmental performance. They also contribute indirectly to this process by encouraging norms of reciprocity and mutual trust essential to collaboration in both the public and private sectors. The notion of social capital can thus be linked to other neo-institutional forms of analysis. Thus in a neo-institutional economic transaction cost analysis those embedded within networks of social capital can minimise transaction costs as the institutionalised conduits of communication and trust which flow between those embedded within its framework act to lower the costs of obtaining information. Thus, in some respects closely mirroring the line of thought popularised by the Developmental State theorists, Putnam (1993: 171) argued that social trust, and hence political and economic development, in modern societies arises from two related sources - norms of reciprocity and networks of civic engagement.

Putnam's (1993) work has, however, been subject to a number of criticisms, the most stringent of which has been the claim that the civic associations of which he discusses hardly appear up to the grand tasks to which he assigns them. (Levi 1996: 47) Similarly, while Putnam's work can be loosely linked to the developmental state literature, his argument that the root of effective government is to be found within civil society basically means that the state becomes, in his theorising, little more than a dependant variable to be noted, but not seriously considered. (Levi 1996: 50) Thus Putnam's work can be seen in some instances to make it appear that state performance is merely a function of social networks, thereby falling into the same socially reductionist trap that the Marxists and Pluralists had fallen into over twenty years ago. Putnam's later work (1995), however, does begin to take issue with this deficiency - with his realisation that the state can act to provide a structure from which fruitful and profitable social relationships can be constructed. In his later work Putnam thus argues that while civic engagement can strengthen state institutions, effective state institutions can also act to create an environment to enable the strengthening of levels of civic engagement. (Putnam 1995) Putnam's later work thus begins to more closely resemble the claims of the later Developmental State theorists that state and society

can act synergistically in order to provide mutual empowerment of each other. This is an important idea as recent research would tend to suggest that the social capital that is most crucial to the success of developmental outcomes is formed in networks that are neither public nor private but instead fill the gap between the two spheres. (Evans 1997c)

While not an exact match for the empirical reality of many East Asian countries Putnam's argument does however follow a broadly similar train of thought to that advanced by the Developmental State theorists, especially in relation to the role of social networks. His work thus provides a useful lens through which to compare and analyse the divergent results of the recent programs of reform in the Cook Islands and Papua New Guinea. In both the Cook Islands and Papua New Guinea a centralised bureaucratic state has been imposed on top of much smaller, previously self-managing societies. The key between the two, and this is a difference which is of crucial importance to any explanation behind the achievement of such different developmental outcomes in these two countries, is the way in which the country's existing social structures and networks interacted during their respective programs of structural reform. In his work on Italy Putnam focused on horizontal civic associations that fostered ties among social equals, that while deeply rooted in history, were not in themselves primordial in character. In contrast to this, however, in the Cook Islands and Papua New Guinea horizontal civic associations have had to vie with the continued existence of strong affective kinship linkages for the loyalty of their constituents. The way in which these linkages were operationalised in the reform process is thus the key to understanding both the success of the Cook Islands reform program and the failure of the Papua New Guinea reform program.

Social Capital in the Cook Islands and Papua New Guinea

In the Cook Islands, existing social institutions and networks interacted positively to both alleviate the negative impacts of the reform process as well as to encourage the positive and successful interaction between various aspects of Cook Islands society in the achievement of the ERPs stated objectives. In contrast to this, similarly framed social institutions and networks to those that had underlain the success of the Cook Islands reform program acted through a variety of social mechanisms to actually

undermine the reform process in the case of Papua New Guinea. And, as we shall see, the key difference behind these two divergent outcomes can actually be traced back to the very concept that supposedly underlies successful forms of state-society interaction – social capital. In both the Cook Islands and Papua New Guinea social capital played a decisive role in the success or failure of their respective programs of structural adjustment and reform. The main difference lay in the manner in which this social capital was operationalised. In the Cook Islands this social capital acted to bring the nation together in a time of hardship and to provide social safety nets for those hit hardest by the reform process. In Papua New Guinea, however, sources of social capital acted to divide the country and to intensify already massive cleavages between and within the countries diverse and heterogenous population. Why this apparent source of social ‘developmental’ capital acted in such very different ways can be traced back to the key difference between these two countries – their relative and absolute degree of social homogeneity.

In the Cook Islands the entire country is relatively socially homogenous. From Penrhyn in the North to Mangaia in the South the various island groups that make up the modern day Cook Islands all share a high degree of social and cultural concordance. Their traditional languages are all mutually intelligible and are probably actually best classified as dialects of the same language. This is not, however, to claim that the population of this country is entirely homogenous or that, in a related theme, there is no cultural or political discordance in the country. In fact the islands of the Northern Group have often discussed the idea of secession from the Cook Islands. In doing so they have cited the loss of much of their Black Pearl derived wealth to the larger population of the Southern Group and their long historical affiliation with island groups now contained within the boundaries of modern day Samoa. However, even in spite of this discordance, no one can deny the high relative degree of social and cultural homogeneity that runs across the entire chain of islands that make up the Cook Islands. Thus while some degree of cultural discordance does exist within the country, when compared to other modern countries of the world, especially those of the African sub-continent, the degree of social and cultural discordance contained within the country pales in comparison. Papua New Guinea, in extreme contrast to the Cook Islands, possesses one of the most heterogenous populations in the world. Divided into several thousand different communities, many

possessing their own unique languages, the population of Papua New Guinea is still, despite twenty-five years of existence as an independent state, intensely fragmented along linguistic, cultural and historical divides. Thus while Papua New Guinea has been an independent state for nearly twenty-five years, its existence as a nation-state is at best merely nationalist political fiction and at worst an ill-conceived joke. Papua New Guinea's stock of social capital is thus severely fragmented along longstanding social and cultural cleavages. While cooperation within the 800 or so socio-cultural groups which make up Papua New Guinea is strong, cooperation between these groups is almost non-existent. In Papua New Guinea the presence of 'too much' social capital has thus acted to severely constrain developmental efforts. The mechanism whereby this abundance of social capital has prevented the achievement of successful reform is quite simple. The high level of social capital contained within the socio-cultural groups that constitute the population of Papua New Guinea has acted to preclude the creation of broader horizontal ties.

Horizontal Ties

The existence of social capital on its own is not enough to bring about developmental success. The necessary complement to the existence of social capital in the achievement of developmental success is in fact the existence of broad forms of horizontal ties. And herein lies the problem. While both the Cook Islands and Papua New Guinea possessed abundant sources of social capital, only in the Cook Islands did this social capital enable the creation of these broader horizontal ties. Once again, however, the reasoning behind this turn of events is both simple and intricately tied to notions of social and cultural homogeneity. In Papua New Guinea the existence of so much diversity between groups has caused the social capital that exists within these groups to be focussed into an extreme form such that while intra-group social capital is high, inter-group social capital is extraordinarily low. Additionally, the mechanism of the wantok system, prevalent across the country, acts to exacerbate this already unstable situation, by further promoting in-group solidarity versus broader non-affective forms of social community. In the Cook Islands the situation is very different. There, a high degree of social homogeneity has meant that enough similarity exists between groups to allow inter-group interaction to occur, thereby facilitating the creation of the broader horizontal links that appear necessary to transform social capital into a positive developmental force. In the Cook Islands this

process has been further promoted through the evangelical nature of the country's Christian churches. This is in direct contrast with Putnam's work where he argues that in Italy the church has not contributed to the construction of the horizontal social linkages he found conducive to the formation of social capital, due he argues to the vertical nature of the linkages between individuals and the church. Thus in Putnam's words "good government in Italy is a product of singing groups and soccer clubs, not prayer." (1993:176) This is not the case, however, in much of Polynesia. In general the Christian churches in the Pacific are Protestant, evangelical, fundamentalist, and hence distrustful of the vertical legacy of the Catholic Church. Thus, in the majority of the Polynesian countries the Protestant, evangelical nature of the churches mean that the Christian church is, unlike in the Italian case, a vital source for those all-important broad horizontal ties. However, while a similar argument could conceivably be made for Papua New Guinea the high degree of social diversity within the country effectively eliminates the positive effects on broader horizontal linkage formation that the Protestant churches may bring. Additionally the Catholic Church, with its tendency towards hierarchy has a very strong presence within Papua New Guinea as opposed to its relative weakness throughout much of Polynesia. This extreme divisiveness, and its negative impact on developmental outcomes is most vividly apparent in the functioning of the country's parliament. There, the mechanisms of wantok-ism and factionalism which categorise the heterogeneous social space of Papua New Guinea, are at their most extreme.

Patrimonialism Patronage and Clientalism in Melanesia

In much of Melanesia, status within groups is based upon the ability of an individual to redistribute wealth through the distribution of gifts. However, it is understood that that such 'gifts' will be repaid later with interest. The most powerful people were those who not only had no debts, but who also were owed debts by others. (Bonnemaison 1978) These individuals who are owed such repayments by a large number of people were often termed as 'big men' within the general anthropological literature. In Melanesia these men of prominence – these 'big men' – are seen to personify power. For these 'big men' within Melanesian society, their status, and the status of the group to which they belong, is thus dependent upon their ability to mobilise resources. Possessing this power is not, however, without its cost. Attached to the power of the big man is thus an associated set of obligations. While he

commands the compliance of those who owe him debts they in return expect his patronage. This practice has many implications for modern political life in Papua New Guinea. There is thus a common understanding in PNG that once a person achieves political office they will help their kin and others who supported their bid for power. (Schoeffel 1996: 99) The fiscal assets of the state are thus often used by Parliamentarians to maintain their patronage networks, both within and outside of Parliament, while implementation of developmental policies is powered by more often by patronage than concern for achieving sustainable development. Thus, in Papua New Guinea commercial and political activities, especially those away from Port Moresby and the other provincial capitals, thus often have a social goal as well as an economic goal.

Government of Papua New Guinea is conducted through a Westminster Parliamentary system where MPs are elected through a first-past-the-post (FPP) election system. The high turn over of MPs, up to 60 percent at each election, limits the degree to which Parliamentarians devote themselves to developing long term policy strategies. The high numbers of candidates who run for political office combined with the peculiarities of the FPP system mean that members of parliament can be elected with less than 10 percent of the vote cast.⁵ The vicissitudes of Papua New Guinean elections, where more than half of the MPs elected in 1992 collected less than 20 percent of the vote cast in their electorate, thus lead to candidates focusing on mobilising support amongst a small band of voters - normally drawn from the candidate's own social-cultural group of wantoks. Campaigning is thus heavily dependent upon the utilisation of traditional forms of redistributive association where by the candidate provides resources in return for votes on the understanding that should they be elected to Parliament they will use their new position to continue to reward their supporters. The widespread utilisation, and acceptance, of these forms of relationship help maintain the fragmentary nature of parliamentary government in Papua New Guinea. This system of redistributive relationships is maintained within parliament itself. The high turnover of MPs combined with the nature of the clientalistic nature of Papua New Guinea politics mean that political parties, where they exist, are based more on ideas of patronage rather than those of ideology. In fact

the notion of political parties in Papua New Guinea does not extend far outside of Parliament building. Party allegiances are constantly shifting as various individuals play parties off against one another in order to acquire the most advantageous position possible to them. A result of this constantly changing political environment in which many small parties vie with one another for power, is that coalition Government is the norm. However, given the patronage basis of these parties, it is no wonder that coalitions are fragile institutions, and mass defections of party members are not rare occurrences. An explanation of the patronage basis of the PNG national political system thus helps to begin to explain the reasons behind both the various fiscal crises that the country has faced over the last decade and the country's failure to successfully achieve occasions of structural adjustment and reform. The state-society forms of linkages that do exist in Papua New Guinea are all predatory in their nature. This, however, is not to preclude the possibility of development in countries, such as Papua New Guinea.

Institutional Transformation

The argument has been made by some (Hollingsworth 1997) that forms of economic coordination and governance cannot be easily transferred from one society to another as they are embedded distinctive social systems of production which are peculiar to their particular social context. To some extent the failure of Papua New Guinea to achieve their developmental goals would appear to uphold that assertion. To leave the argument there, however, would be to both hopelessly over-simplify the debate as well as needlessly condemn those countries that did not fit into the 'Western' or 'East Asian' mould to an inescapable future of underdevelopment. The answer to this seeming paradox lies in the dynamic nature of institutions themselves.

Institutional Change

While Peter Evans (1997c) has argued that while state-society synergy is most easily fostered in societies characterised by egalitarian social structures and robust, coherent state bureaucracies, Evans has also argued that synergy is constructable, even in the more adverse circumstances typical of third world countries. Evans thus argues, the

⁵ In the 1997 election 2 232 candidates contested 109 seats, a ratio on average of over twenty

key to state-society synergy is the translation of “social ties from engines of parochial loyalties onto vehicles for more encompassing forms of organisation.” (Evans 1997c: 192) The fluid and dynamic nature of institutions provides us with the means by which we can overcome the developmental dead-end that the Developmental Statist literature at first glance appears to assign to countries with heterogenous populations. Structural Adjustment Programs set out not only to change the material relations of existence but the very norms and values that underlay that ‘new’ existence. Implementing reforms does not thus just involve changing structures, rules, and procedures. Countries hoping to achieve lasting change need to transform peoples attitudes. Societies, however, may *not* benefit from trade or specialisation if the transactions costs incurred in the process of exchange outweighs the benefit of an exchange. (Ensminger 1992: 18) Governments and other organisations reduce transaction costs by the clear specification of property rights, the provision of information and the enforcement of law and order. Economic growth does not therefore come from technological change alone, instead following the work of the NIEs institutional change, especially that which reduces transaction costs, is the key to obtaining economic growth. (Ensminger 1992:18)

The first step in transforming the developmental state literature into a broader policy instrument is thus the realisation that development must be treated as a dynamic process. Institutions are sticky – that is they are highly resistant to dramatic periods of change – but they nonetheless are themselves constantly changing in light of changing social forces. Viewing development as a process entails having a design that is flexible and changes as a result of learning from the implementation process. (Mosse 1998: 4) Additionally, the realisation must also be made that all projects, even the most cut and dried, have permeable boundaries and are influenced by their wider social and institutional environments. For as Pierre Landell-Mills (1992) has claimed:

the design and operational practices of public institutions must be at one with the social values of the society in which they are embedded...[as] formal rules alone

cannot protect an institution if its members do not behave in a manner consistent with the values that underlie the rules. (1992: 546)

Lastly, but most importantly, the realisation of the implicit basis of social homogeneity behind the success of the East Asian developmental states also needs to be acknowledged. Only once this has been done, can we then begin to modify the various models of the developmental state that exist in the literature towards dealing with the problem of heterogeneity.

Conclusion

In drawing out the implications of this thesis we can learn much from the work of Peter Ekeh. In his analysis of post-colonial Africa Peter Ekeh (1975) identified the existence of two quite separate public realms, both of which are still readily identifiable in many of the developing countries of the world, including those of the Pacific. Within these countries government operates within both a 'primordial' public realm (governed by primordial groupings, ties and sentiments) and a colonially derived 'civic' realm (governed by Western ideals of accountability and professionalism). While this primordial public realm continues to exist within both countries it's effects however have led to very different reform outcomes. The problem appears to not be one of dismantling this primordial and often heterogenous realm as the earlier Modernisation theorists claimed, but rather of finding ways in which to harness the social resources found within this diversity for the achievement of developmental goals. The developmental state model, as it presently stands, does have problems. However, if the steps shown above are successfully used to modify and augment the current models, as governance, in all its various guises, should always be rooted in local processes, then the developmental state paradigm may yet provide us with a useful and effective developmental model,

APPENDIX ONE

COOK ISLANDS ERP OBJECTIVES

Public Sector Reform

- Redefine the role of government emphasising policy and regulatory functions
- Fiscal responsibility
- Ensure effective financial and economic management
- Improve public sector management and efficiency

Promoting Private Sector Growth

- Promote public confidence in the reform program
- Improve the environment for competitive private sector-led growth
- Facilitate access to capital through an efficient financial sector
- Improve access to business advice
- Simplify access to land
- Facilitate foreign and domestic investment by the private sector
- Develop agriculture
- Develop marine resources
- Develop tourism
- Develop other productive sectors

Social Equity and Sustainability

- Support and protect vulnerable groups
- Ensure environmentally sustainable socioeconomic development
- Mainstream gender issues into development planning

(Source: ADB 1998)

APPENDIX TWO

PAPUA NEW GUINEA SAP OBJECTIVES

- 1) Revise macro-targets to achieve macro-economic stability.
- 2) Maintain a competitive and market determined exchange rate.
- 3) Eliminate budget transfers to all commercial statutory authorities.
- 4) Maintain a wage freeze from April 1995 to December 1995.
- 5) Restructure the public service to increase efficiency through retrenchment, improved personnel management systems, and improved payroll efficiency.
- 6) Abolish the statutory minimum wage.
- 7) Restructure the Department of Finance and Planning.
- 8) Make adequate counterpart funding available.
- 9) Implement a tariff/indirect tax study.
- 10) Abolish remaining reserve activities.
- 11) Repeal regulations to the Investment Promotion Act.
- 12) Abolish remaining price controls.
- 13) Complete current privatisation sales.
- 14) Complete framework legislation for customary land registration.
- 15) Re-examine the roles of the IPA and limit the role of the IPA to that of promotion not gatekeeper.
- 16) Introduce tax incentive policies into tax/customs legislation.
- 17) Forestry Issues:
 - a) Maintain power with the Forestry Board not the Minister;
 - b) Ensure that landowners get a minimum of K20 per square metre of logs in excess of K100 per cubic metre (hold part in trust funds);
 - c) Ensure that all new licences meet sustainability criteria;
 - d) Continue to fund the National Forest Authority and SGS (PNG) in 1995 real terms.
- 18) Make coffee/livestock and other industry corporations financially autonomous by December 1996 and refrain from establishing new corporations.
- 19) Introduce domestic market reforms by fully liberalising produce marketing, processing and abattoir activities.

- 20) Develop and implement a rescheduling of Rural Development Bank plantation debt.
- 21) Require industry corporation to assume responsibility for price support/stabilisation.
- 22) Review expenditure targets and planning in order to achieve targets for 1995 and agree with the World Bank on targets for 1996-1999. Provide adequate funding for the Social Fund.
- 23) Shift resources to local authorities and give local authorities the ability to hire and fire.
- 24) Set up autonomous non-government organisation funds to the value of K4-K5 million.
- 25) Introduce health reforms:
 - a) Close or sell under-utilised health services;
 - b) Encourage provincial health boards;
 - c) Introduce higher outpatient fees; and
 - d) Introduce new procedures for pharmaceutical sales.
- 26) Introduce a system of fees and loans for tertiary students in order to help recover costs.
- 27) Prepare an action plan for Public Sector Reform following departments and agencies including:
 - a) Finance;
 - b) Agriculture;
 - c) Health;
 - d) Higher Education;
 - e) Trade;
 - f) Industry;
 - g) Tourism;
 - h) Transport;
 - i) Works;
 - j) Energy; and
 - k) Environment.

(Source: Mawuli 1997)

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The National (Port Moresby). Daily.

PC, *The Post Courier* (Port Moresby). Daily.

People Interviewed

United States of America

Mr Bilal Rahill
Country Officer – PNG

World Bank
Thursday 23/4/98
13:00-14:00

Ms Sara Menon
United Nations Development Programme – South Pacific Division
Friday 24/4/98
11:00-12:00

Papua New Guinea

Professor Ted Wolfers
Prime Ministers Department
Sunday 21/11/99
21:00-23:00

Mr Michael Manning
Director
Institute of National Affairs
Monday 22/11/99
9:00-9:45

Mr Simon Peter
Investment Promotion Authority
Monday 22/11/99
10:20-11:05

Mr Lawrence Stevens
General Secretary
Catholic Bishops Conference
Tuesday 23/11/99
10:00-11:00

Mr Wayne Golding OBE
Chairman
Manufacturing Council of PNG
Tuesday 23/11/99
2:40-3:40

Dr Orovou Sepoe
Lecturer
Department of Political Science and Public Administration – UPNG
Wednesday 24/11/99
10:00-10:45

Mr Daniel Aloï
Lecturer and Head of Department
Department of Political Science and Public Administration – UPNG

Wednesday 24/11/99
10:45-12:15

Mr Brian Brunton
Greenpeace
Wednesday 24/11/99
13:00-13:45

Mr John Paska
General Secretary
PNG Trade Union Congress
Thursday 25/11/99
9:15-9:50

Mr Clarence Hoot
Ministry of Trade and Industry
Thursday 25/11/99
10:20-11:00

Mr Paolo de Lorenzo
Planning Commission
Thursday 25/11/99
11:30-12:30

Mr Henry Kila
President
Business Council of PNG
Thursday 25/11/99
3:45-4:10

Mr Paul Barker
Prime Ministers Department
Wednesday 24/11/99
18:30-19:30
and
Thursday 25/11/99
19:30-21:30

Cook Islands

Professor Ron Crocombe
Sunday 5/12/99
1:00-3:00

Mr Tata Crocombe
General Manager
Rarotongan Hotel

Sunday 5/12/99
13:50-14:45

Sir Tom Davis
Former Prime Minister of the Cook Islands
Monday 6/12/99
9:20-10:00

Mr John Tangi
Executive Advisor
Ministry of Outer Island Development
Monday 6/12/99
11:10-11:30

Mr Kato Tama
Head of Ministry
Ministry of Outer Island Development
Monday 6/12/99
11:30-12:30

Mr Wilkie Rasmussen
Secretary to Cabinet
Monday 6/12/99
12:45-13:30

Mr Tupu Araitu
Deputy Secretary
Ministry of Finance and Economic Management
Monday 6/12/99
15:00-16:00

H.E. Rob Moore-Jones
New Zealand High Commissioner
Tuesday 7/12/99
9:00-9:45

Mr Rohan Ellis
Director
Development Investment Board
Tuesday 7/12/99
9:55-10:45

Mrs Jill Vaiimene
Former President of the Public Service Association (PSA)
Wednesday 8/12/99
10:15-11:00

Mr Alex Sword
Editor
Cook Island News

Wednesday 8/12/99
13:00-14:00

Mr Temu Okotai
Former Chief of Staff of the Prime Minister's Office/Businessman
Wednesday 8/12/99
14:00-14:30

Mrs Vaine Wichman
Consultant
Thursday 9/12/99
8:30-10:00

Mr Brett Porter
Former President of the Cook Islands Chamber of Commerce/Businessman
Thursday 9/12/99
10:30-11:30

Mr Navy Epati
Head of Ministry
Public Service Commission
Thursday 9/12/99
14:45-16:00

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